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california management review

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SUMMER 1961 • VOLUME III • NUMBER 4

Published by the Graduate Schools of Business Administration, University of California, Berkeley and Los Angeles.

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SUMMER, 1961 • VOLUME III • NUMBER 4

Edited under the direction of the Faculties of the Departments of Business Administration, University of California, Berkeley and Los Angeles.

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PROBLEMS OF ECONOMIC GROWTH AND AUTOMATION

WILLIAM GOMBERG

Call it displacement, technological unemployment, or what you will, automation is downgrading skilled labor, including white-collar workers and technicians, this labor expert observes, and points out that capital is also being constricted. He does not think the "whirling dervish of compulsive consumption" and its handmaiden synthetic obsolescence are stable props for an economy just emerging from a recession; suggests tax reform and an overhaul of classic economic concepts of wages and profits instead.

Dr. Gomberg, Professor of Industry at the Wharton School of Finance and Commerce, University of Pennsylvania, spent twenty-two years of his working life as a union official. He was hired by the International Ladies' Garment Workers' Union in 1934, just after graduation from CCNY with honors and a B.S. in Engineering, to serve as a contract administrator and remained with the union through 1956. In 1941, he founded and became Director of ILGWU's Management Engineering Department, a unique project for a union to sponsor, because its job is working with employers to cut production costs. Making time studies, formulating wage and incentive plans, designing operational sequences are all part of the day's work for its staff of seven engineers. In addition, Dr. Gomberg has arbitrated a number of strikes, among them the 1949 month-long walkout of the UAW against the Ford Motor Company.

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EMPLOYMENT

Industrial engineers, these days, are in the rather unenviable position of taking some of the advice they have been wont to dispense. Engineers have always counseled the blue collar work force about the folly of interfering with progress by opposing the application of work measurement and simplification to blue collar tasks.

They could always rely on a public ally in the white collar group. Now, the new industrial revolution is making both the white collar worker and the professional industrial engineer as obsolete as many of the blue collar workers have become.

Clerical Automation

The extension of office machinery to many routine office jobs bids fair to arrest the extension of job opportuni-

ties in the white collar area, the refuge, hitherto, for the better educated children of the blue collar group. The old time study engineer is faced with the doctrine that if a job can be time studied then it is repetitive enough to be automated, and its sub-human character makes this change an ethical must.

The industrial engineer is not alone in his professional obsolescence. Not too long ago *The New York Times* reported the presentation of a paper before the American Institute of Chemical Engineers that indicates that a computer was able to design an actual chemical plant more efficiently, rapidly, and cheaply than a team of engineers. The plant, designed for Shell Oil Company, cost less than a competitive design proposed by the

engineers (one-half million dollars). In addition, the new plant is expected to cut production costs by five to ten percent.

Outmoded Technicians

Graduate engineers find their skills obsolescent a few years after graduation when they must compete with the new crop of eager beavers only too ready to dismiss their seniors, who are still in their thirties, as old fogies.

Douglas MacGregor² has observed that the white collar and professional classes have reacted to this threat of obsolescence with very little of the philosophical calm which they have counseled for the blue collar groups. This would be amusing if it were not so serious.

This year Congressman Elmer Holland of Pennsylvania submitted to President Kennedy some details of material he has received from the country's unions. Here is his report broken down by industry:³

Steel—Productivity increased 121% and employment declined 18.5% from 1937 to 1959.

Autos—Some 160,000 unemployed auto workers in Detroit will never return to factories due to automation.

Coal Mining—Productivity has increased 100% since 1950 with each miner producing 12 tons per day compared to six tons in 1950.

Office Workers—The number of employees has decreased 25% in the last five years and is expected to decline another 4,000,000 to 5,000,000 in the next five years. This estimate is based on what the office workers union has experienced to date and what it anticipates will happen by 1966.

Telephones—Business has increased 25% but there are 30,000 fewer jobs today than 10 years ago. This decline is expected to continue with the expansion of the dial system.

Electrical Machinery—Productivity rose 20% but 80,000 jobs disappeared from 1953 to 1960.

Electric Bulbs—Productivity has risen 52%. The number of bulbs shipped has risen 42% and about 1,500 jobs were lost from 1950 to 1960. Westinghouse has just completed a completely automatic machine which can turn out 32,000,000 incandescent bulbs per year.

Railroads—1,000,000 jobs have been eliminated by mechanization in the last ten years and more are on their way out.

Building Service—The vending machines are replacing sales clerks, automatic elevators have displaced 25,000 elevator operators, cleaning machines have replaced janitors, etc.

In agriculture the situation is even more acute. In 1958 over a million farm families had incomes from all sources, including locally raised food, of less than \$2,500 per year.

Automation Invades Farm

In 1954, the latest date for which data are available, 12% of all farms—those with sales of \$10,000 or more—marketed 58% of all farm products. At the other extreme, families obtaining most of their income from farms, but on small farms—43% of the total—produced only 9% of the farm produce marketed.

Thirty percent of the establishments listed as farms were part time farms or country residences and pro-

duced only 2% of the farm products marketed. In other words, 73% of the existing farms marketed 11% of the farm produce. The number of farms with sales over \$2,500 has remained a constant 2.1 million. Attrition can be expected to liquidate the remaining farms except for those affluent country residence occupants who remain in farming to take advantage of tax losses.

Between 1947 and 1949, farm output per unit of input has increased 24%. The rate of increase in farm output per hour has been three times the rate of increase for non-farmworkers. Approximately 220,000 farm boys reach working age each year. For them there are only 23,000 openings for new farmers on farms in any given year. The rest, nearly 200,000 strong each year, must make a place for themselves in industry.¹

Yet, because of the higher birth rate in the 1940's, the farm boys will meet increased competition for industrial jobs from city-bred young workers, just entering the labor force. At present 2,600,000 young workers enter the labor force each year and, because of the heavy postwar marriage and birth rate which did not taper off until the recession, this figure is apt to remain that high for the next decade.

A number of questions present themselves when we look at these data:

- Is there real cause for alarm, or will the normal compensating devices of our economy restore full employment?
- What is the nature of the jobs that are developing out of automation? Do they call for higher or lower skills?
- What happens to workers actually displaced?

- Is it rational to continue to rely upon wage payments as a principal means of income distribution to maintain the purchasing power necessary to keep the economy operating?
- What are some alternative ways of combining rational distribution with the continued separation of centers of political power from centers of economic power? In other words, how do we maintain decentralized power centers in our society?

All of these problems can be summarized by a question which Professor George W. Taylor of the University of Pennsylvania poses, "For what do we pay wages?"

We can well begin with an examination of the thinking of the neoclassical type of economist who sees no cause for alarm. Yale Brozen of the University of Chicago insists that we must recognize that there is no such thing as technological unemployment.² He does indicate that there is technical displacement. He goes on to say that we always recognize this displacement, but that we seldom pay attention to the absorption of workers which occurs because of technical change.

Displacement or Unemployment?

Brozen, of course, is able to demonstrate on balance that at a given wage level more jobs have been created than eliminated by technological change in the past. Reasoning of this type is inadequate for future guidance because it provides no guide for the future.

It commits the fallacy of extrapolating the future as an image of the past. Then again it creates an amalgam of

anonymous workers without any differentiation. The machinist who loses his job at fifty is not the man who gets the job of the electrical engineer on the new numerical control of the automated milling machine.

Brozen is right within limits. Unemployment can result from an underindustrialized, undercapitalized economy. All that we need do is look at the unemployment problems of countries such as the new emerging Asian and African nations to verify his observations. In a sense they are repeating our past albeit at a more rapid tempo.

Don't Look Backward

Although the past is a guide to the future, it does not follow that the future will mirror the past. A "foo foo" bird approach to our problem is irresponsible. (Some years ago the foo foo bird was a widely advertised novelty on sale at florists' shops. It was described as a bird that flies madly forward looking backward. It's indifferent to where it is going but very curious about where it came from.)

Professor Charles Killingsworth of Michigan State University⁶ takes a different point of view. Professor Killingsworth, in his remarks before the Manpower Subcommittee of the United States Senate, bitterly declared that while everybody is talking about automation, nobody actually knows what is happening.

He then went on to remark that we behave in the best tradition of the nineteenth century in assuming that there is some natural law that the number of jobs created by a new technology will always exceed the number of jobs abolished. Professor Killingsworth insisted that what is needed is a large scale study to determine exactly what is happening

and what can be expected to happen.

Very few people have looked; they have preferred to speculate. Some have made assumptions about the changing nature of jobs on the basis of questionable observation. One of the men who has actually looked is Professor James Bright of Harvard. Professor Bright, in a paper delivered in 1960 at the National Conference of the Labor Relations Council, held at the University of Pennsylvania,⁷ dismisses a number of myths that have developed as automation casts its shadow across the horizon.

Automation Can Downgrade Labor

Myth number one was the conviction that the increasing complexity of controls incidental to the automation process would lead to a substantial upgrading of the work force. Bright found that the very opposite was true—that frequent instances were discovered where the management, victimized by its own mythology, had upgraded new jobs only to find that it had made substantial errors in assigning high wage rates to automated jobs. From a job evaluation point of view, training time for these jobs had been badly overrated, and new high rates for the automated jobs were unfair when contrasted with the wages of workers operating conventional machinery. His conclusions were that, though there were examples of skill increases required by automation, their importance seemed vastly exaggerated.

Bright analyzed the factors that make up the workers' contribution to any task. He lists twelve variables that are generally found in any job evaluation system.

They are physical effort, mental effort, manipulative skill, general skill,

education, experience, exposure to hazards, undesirable job conditions, responsibility and decision making. He found that, in the early stages of mechanization, there was some upgrading in these factors, but as the mechanization increased until the process approached automatization, the very reverse took place.

His final conclusion was that the average worker will master different jobs more quickly. Many key jobs requiring long experience and training will be reduced to easily learned, machine-tending jobs.

Skill vs. Machine-Tending

Bright poses the wage problem arising out of automation in the following terms: "If the operator does not control quality and quantity; if he makes fewer production operation decisions; if he exerts less physical and mental effort; if automation reduces the need for skill, education and experience; if automation removes job hazards and improves working conditions, then many traditional worker contributions are of lesser or even no economic value."

This, of course, means that with widespread automation, there will be fewer workers, and they should expect to receive less money per capita than they receive now. Add to this the results of the continuing agricultural revolution and its displacement of the farm population, and we are left with the question—how do we generate customers for mass output if wages and farm income are destined to become a smaller and smaller part of national income, or worse—a constant proportion of a shrinking income.

This brings us face to face with the dilemma posed by Professor Taylor, "For what do we pay wages?"

What Are Wages Paid For?

Wages were originally paid for work done. An employer had no high-flown notions about responsibility to add his share to the purchasing power of the country when he fixed a wage. The function of management was to minimize cost and predict these self-same costs.

Even Henry Ford, whose \$5 per day is credited with sparking a revolution in wage payments, did not hesitate to point out that he was paying a premium to skim the cream off the labor force. Five dollars per day was available as long as the worker was productive. The industrial scrap pile was his fate as soon as advancing age took him out of the cream bracket.

Sophisticated economists have talked of wages providing the purchasing engine behind the affluence of the American economy. This thinking was coming into vogue even before the abandonment of Say's discredited Law that the very act of production always generates enough purchasing power to take the full product off the market either by way of consumer goods or capital investment.

Employers rationalized their wage payments in terms of specific job characteristics that they listed in either informal job classification or formal job evaluation schemes. The results of their activity, incidentally, served the larger purposes of mounting the purchasing power machine.

The classical economist remains untroubled by this dilemma. He merely updates the language of Say's Law that there can never be a problem of purchasing power, that the very act of production generates the income to take the entire product off the market. Professor Yale Brozen, whose

thinking we have examined, is a leading exponent of this school of thought.

It is quite true that automation as a concept is not new. On the other hand, it is an old rule of thumb that when a phenomenon increases tenfold in size, the difference in the kind of problem it presents ceases to be a difference in degree. It becomes a difference in kind. Automation is a euphemism for an explosion in the increased rate of technical change.

Fate of Displaced Workers

It is noteworthy to determine just what happens to workers who are displaced. A study was undertaken by Harold L. Sheppard, Louis A. Ferman, and Seymour Faber of the Institute of Labor and Industrial Relations, University of Michigan and Wayne State University, to determine what happened to the employees of the Packard Motor Company when that factory went out of business in 1956.¹

They confined their study to what happened to 500 former employees of the Packard Motor Company during 1957 and 1958 after the Packard plant in Detroit was closed. Fourteen percent of these workers were under the age of 40. Over 50 percent were past the age of 55.

When interviewed, one to two years after being laid off, it was discovered that 22 percent of them had not been able to find any jobs at all, and 51 percent had been out of work long enough to exhaust their unemployment compensation. Those who did find jobs took work requiring a much lower level of skill and paying lower wages than their old employment. Whatever the long term adjustments for the labor force as a whole, these individual tragedies lend poignance

to a problem too often lost in cold statistics.

Are we to argue from this evidence that the current recession arises because labor as a group is not receiving its share of the increases in productivity of our economy? This seems hardly borne out by statistical evidence available—at least at first glance.

Professor John Kendrick² of George Washington University and the National Bureau of Economic Research are able to demonstrate that, by any of our conventional rules of justice, labor has received more than its share of the increment from increasing productivity since the close of World War I.

Kendrick defines productivity increases as the difference between the total change in real income or product and the change required to compensate added inputs. He states that the combined input of labor and capital has increased at the rate of 1 percent per year since World War I. Real national product rose by 3.1 percent. Thus he argues that output per unit of total input or total factor productivity increased at an average rate of 2.1 percent per year over the 38-year period 1919–1957.

Wage Rises Outstrip Productivity

In dividing this compounded 2.1 percent per year between the factors of production, he concludes that the rate of return to capital has remained a constant; that is, the rate of return to capital rose only in proportion to the increase in real capital stocks and less than the increase in output per unit of capital input, which averaged 1.3 percent last year. Thus, practically all of the increment productivity (99 percent) accrued to labor.

In terms of average rates, real average hourly labor compensation increased by 2.8 percent per year compared to a total increase to total factor productivity of 2.1 percent per year.

(Of course, the assumption that is always implicit in studies like Kendrick's is that the base period divisions of income between the factors of production were governed by a sense of justice or equity which should be extended into the future.)

The problem raised by Kendrick's very competent and scholarly analysis is whether or not the criterion of our conventions of economic justice, implicit in his findings makes operational sense for the needs of an expanding economy.

Capital and labor make up a system and arguments between them over who is entitled to a greater share of the increment yield of the system's output based upon a contrived equation of relative contributions of each factor makes as little sense as an argument between the liver and the lungs over who is entitled to a greater share of the body's food intake based upon each organ's relative contributions to the body's life force.

Their food needs and relative contributions to the body's survival are independent variables. Is it not possible that a similar state of affairs characterizes our economy?

Ordinary observation would disclose that the incremental increase in production over the years is quite obviously attributable in the main to better tools. The only way that labor could contribute to this increase, if we omit the factor of training and education, is by working both longer and faster. No labor leader could advance this argument without bearing wit-

ness to either his complete ineffectiveness or his lack of observation.

Are we to argue, therefore, along the lines of the Puritan ethic, that an injustice has been done—that capital has been robbed of its proper reward? Quite clearly what is at fault here is that we have identified an ideological model of justice with the pragmatic operational needs of a growing economy.

Drop in Capital Return Rate

What are those needs? Paradoxically, it turns out that our solution calls for the channeling of additional investment funds into the public and private sectors of our economy, in which the overall rate of return on capital must continue to decrease.

Rosalind Shulman, a doctoral student at the University of Pennsylvania, has developed data that seem to lead to the following tentative observations.¹⁰

The analysis begins with the following demonstrations: (1) That the tendency of consumers to save increases with increasing income. (2) That as this consumption increases proportionately, more of that income is spent for services than for goods; that is, above a modest but adequate level of consumption. (3) That below a certain level of consumption, dissaving takes place; that is, the consumer is subsidized by relatives or the state.

As a corollary to these observations about consumption, the following observations about investment may be listed. (1) Investment for the production of capital goods and consumer durables in the United States has been declining. (2) Investment in the private sector of the economy is presently at the point where it has been overfinanced by retained private earnings

within the corporation, private savings, expended through investment trusts, bank extension of private savings expended through investment private savings.

Drop in Capital-Output Ratio

Small business has been investing by and large in industries where the ratio of capital investment to output is small. These are, as a rule, the service industries. It is unlikely that the activity of the Small Business Investors Corporation of the government will increase this ratio during the foreseeable future. This reflects itself in a decreasing capital-output ratio which has been apparent since 1914.

A group of investigators headed by Daniel Creamer¹¹ has traced the ratio of capital to output in terms of 1929 prices. Here are their findings.

Benchmark	Ratio of Capital to Output (1929 prices)
Years	
1880.....	0.547
1890.....	0.730
1904.....	0.891
1909.....	0.967
1914.....	1.008
1919.....	1.022
1929.....	0.885
1937.....	0.741
1948.....	0.609
1953.....	0.590

It will be noted that the capital-output ratio increased from 1880 to 1914, but has been decreasing steadily since 1919.

We are face to face, experiencing as we are now the aftermath of the 1960 recession, with a phenomenon first described by Veblen in *Absentee Ownership*. He pointed out that only a price-administered private industry can carry the debt burden engen-

dered by an increase in capitalization during a downturn in the business cycle. This inability to expand in the face of falling markets is clearly visible at present in the manufacture of certain consumer durable goods, some sectors of the aircraft industry, and the automobile trade.

Where Can Capital Go?

An increase in the ratio of capital to income is feasible in capital goods industries and consumer durables. However, since increasing consumer income leads away from goods to services, there is little likelihood of expansion in this area.

The degree of capitalization that is possible in the service goods industries does not match the proportionally decreasing requirements of the other sectors of the private capital and consumer durable goods industries. Even if every store were a supermarket, every restaurant an automat, every insurance and bank fully computerized, it would not mean sufficient increase in the capital-production or income ratio to absorb all available savings from the various sources in this country.

Much private innovation in progress is of the type that reduces the capital-output ratio, for example, miniaturization of electrical components, and oxygenation of steel mills. Even government armament programs do not have the effect of increasing the capital-income ratio because of the tremendous amount of already available capital built during World War II and the Korean conflict.

Government armaments merely increase the intensity of the business cycle because the very nature of government planning in this area must be determined by minimizing the time

between innovation and hardware, rather than by the vagaries of our economic system.

Space and Atoms—U. S. Property

The major investments that are available, which would lead to an increase in the capital-product ratio, are those unlikely to attract private funds in their initial stages. The major breakthroughs in twentieth century technology are in the areas of atomic energy and space exploration. These must be subsidized as were the railroads in their initial stages of development and as the airlines continue to be.

Professor Thomas Cochran¹² has indicated that most of our major economic undertakings from the time of the Erie Canal were the beneficiaries of such subsidies. The extent to which these subsidies continue to operate is disclosed in a recent government study.¹³

It is the public sectors of the economy that require additional capitalization rather than the private sectors; for example, education, transportation, roads, airports, river and harbor development, natural resource conservation, hospitals, and urban renewal.

Cheap Housing? Too Little Profit

Until the post-war population increase reaches adulthood, we shall remain in the declining phase of the building cycle, except for the one sector of building construction which private enterprise has not been able to handle—low income housing. Even the late Senator Taft was convinced that some form of government assistance would be necessary to clear slums and create low-income housing.

Proposed measures for the relaxa-

tion of credit and other fiscal and monetary controls are unlikely to create investment opportunities for the private capital and durable consumer goods sectors of the economy. In all likelihood, they will merely drive up the price of existing equities rather than create new ones.

Consumption Carousel Slowing Down

The behavior of the consumption pattern in the United States indicates that the standard remedy of the high purchasing power advocates might affect the consumers in the lowest sector of the population by raising their propensity to consume. In the higher brackets, it would probably lead to proportionately more savings than it would to more consumption, with consequent stagnation. This is not necessarily unfortunate. Why must we depend upon a whirling dervish economy keyed to compulsive consumption?

John Galbraith¹⁴ has raised the fundamental question of whether or not an economy that depends for its dynamism on the consumption of more and more consumer goods makes sense. This is not to argue that an unemployed worker who is left without the means of sustenance, or barely survives on an unemployment insurance or relief allotment, should take refuge in the pleasure of being a member of a new hair-shirt leisure class, a sort of industrial beachcomber, if you will.

Synthetic Obsolescence

The question is, must our economy depend for its investment incentives on an irrational desire for more and more automobiles that will replace perfectly sound transportation vehi-

cles in order that automobile workers may eat, or on a whole host of consumption goods that are trivial and silly, so that novelty workers may continue to eat.

Must it depend upon a synthetic obsolescence of perfectly adequate clothing, television sets, and refrigerators to provide jobs for workers assigned to make these items?

Economic "Whirling Dervish"

In the past, the mainsprings of our growth have been keyed to new products and services that called for tremendous investment. During the nineteenth and early twentieth centuries, it was railroads and construction. Later, it became the automobile, television and radio.

Where does all of this lead? Today's basic technological innovations call for capital expenditures in the very areas where a high capital-income ratio makes the investment relatively unattractive to our private investors.

Although private investment has shown some readiness to undertake these investments after the government has financed many of the the basic risk-taking and innovating functions, it would be unrealistic in the extreme to expect it to do the pioneering job which, a century ago, private capital assumed in building railroads, for example.

Times have changed, along with the tax structure, and are forcing a reexamination of certain investment financing concepts.

Government, the New Entrepreneur

In a sense, the government has become a party to increasing the capital-income ratio. If we divide our capital

assets between the government and private investors and average out the capital product ratio, we get the rate of return that is rational at full employment levels in the performance of useful work.

Government obviously must satisfy itself with a much higher ratio than private investors are willing to risk if much necessary work is to be done that is not suited to the private market economy. In a sense may we not then argue that it is the private investor who is being subsidized beyond his earned return? A proper criterion of economic justice might dictate a much lower return than he is willing to take.

Government Spending Aids Economy

As late as 1959, military activities of the U. S. Government took 8.6 percent of the gross national product.¹⁵ In 1953, they took 12 percent. Yet, when we analyze the manner in which this investment was expended, we find that the overwhelming part of it was spent in the private sector of the economy.

For example, between July 1, 1957, and June 30, 1958, 33 blue chip corporations made from two to 99 percent of their total sales as the result of defense orders.¹⁶ They are listed, along with the percentage of their total sales, accounted for by government orders, in the table on page 15.

During the third quarter of 1960, purchases of all goods and services by the federal government accounted for 10.5 percent of GNP. State and local governments bought another 9.5 percent of GNP.¹⁷ The greater part of these purchases was made from privately owned firms. So, instead of grudgingly considering such huge government spending as a waste, we

EFFECT OF DEFENSE PURCHASES ON THIRTY-THREE CORPORATIONS

Company	Defense Sales Expressed as % of total company sales, 1958
General Electric Company	24.0
Lockheed Aircraft Corporation	86.0
United Aircraft Corporation	88.0
Douglas Aircraft Company	78.7
Martin Company	99.2
Sperry-Rand Corporation	41.0
International Business Machines	20.0
Radio Corporation of America	25.9
General Motors Corporation	5.0
Westinghouse Electric Corporation	19.0
Chrysler Corporation	15.0
Raytheon Manufacturing Company	86.0
Bendix Aviation Corporation	73.0
General Tire & Rubber Company	46.0
Ford Motor Company	9.3
Avco Manufacturing Corporation	60.5
Bell Aircraft Corporation	81.0
Burroughs Corporation	15.0
Philco Corporation	31.0
Thompson Products, Inc.	80.0
Food Machinery & Chemical Corp.	22.0
Thiokol Chemical Corporation	83.5
General Precision Equipment Corp.	66.0
Minneapolis-Honeywell Company	28.0
Garrett Corporation	78.0
Lear, Inc.	90.0
Sylvania Electric Products, Inc.	23.0
Westinghouse Airbrake Company	33.0
Hercules Powder Company	2.0
Eastman Kodak Company	4.0
Cessna Aircraft Company	60-75.0
Beech Aircraft Corporation	67.0
Ryan Aeronautical Company	60.0

should actually look upon it as an investment.

If we pursue this same pattern of decentralized execution of capital investments by making use of private industry and quasi-public bodies like T.V.A. and various public authorities, we can maintain a level of investment high enough to keep America employed, without centralizing all politi-

cal and economic power in one area.

Here we have to make a choice. If we use the government for all our investment decisions, we concentrate a dangerous combination of economic and political power in one area that could breed tyranny.

The subsidy of the private investor combined with the illusion of his autonomy, is a small price to pay for preserving some decentralized centers of economic power.

However, we must recognize that taxation is not a burden but an investment. Rather than look for reductions in our tax load, the expansion of our economy, even in peacetime, will probably require a substantial tax load to fulfill our innovating heavy capital needs.

Tax Rise and Reform Possible

As matters stand now, government expenditures are an important part of our economy. The problem, therefore, of putting America back to work in an age of automation may very well be to increase, rather than decrease taxes.

Paradoxically, along with these increases in taxes, we may see a more rational distribution of the tax load. Such tax reforms should include:

- A more realistic treatment of depreciation schedules that will accelerate the tax life of a capital investment.
- A limitation upon the right of large corporate managements to withhold earnings from the stockholder so that he would be free to decide whether or not he cares to reinvest in the expansion of the enterprise. (This is nothing but the extension of the utility method of finance to all enterprises.) Such measures would encourage addi-

- tional investment, particularly by small income holders and cut down evasion of tax obligations through capital income gimmicks.
- A reduction in the upper bracket tax schedules to further cut down the popular preoccupation with capital gains deals which drain capital from productive enterprises into those of less economic worth merely because the latter offer tax advantages. This would also free additional venture capital and provide a realistic framework within which the tax reforms listed above could be administered.
- Revision of the Federal budget to reflect the difference between "wasting expenditures" and capital investment.

In combination, all of these measures could not only stimulate recovery

from the recent business recession and counter some of the inevitably detrimental effects of automation on labor, but also benefit capital and the total economy.

Their adoption would encourage the movement of capital, widen the base of participation in stockholdings, and make available to government an adequate reservoir of investment funds for activities whose capital-product ratio is too high to attract private investors. Best of all, they could put America back to work without, as is the case at present, a pathetic reliance on the whirling dervish of compulsive consumption.

Pump priming has become a misleading and obsolete concept. The government and quasi-public authorities have become, and must continue to be, greater and greater investors in our economy.

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	2.30	18	58%	
	40	5		
			17	



COMBATING DISCRIMINATION IN EMPLOYMENT

PAUL BULLOCK is associated with the UCLA Institute of Industrial Relations as Staff Specialist in Industrial Relations. Last year, he published a study dealing with standards of wage determination. This year, upon completion of the survey of merit employment policies and practices described here, he began work upon his current project, research into automation and work rules, with particular reference to the recent agreement upon the subject between the International Longshoremen's and Warehousemen's Union and the Pacific Maritime Association.

Merit employment is not only the law of the land, but good business and good sense, employers who have tried it state, and tell how they broke the ice to let economics work with ethics to right old wrongs and vanquish discrimination on the job.

In recent years, most Americans have become acutely conscious of the far-ranging international repercussions of their own values, attitudes, and behavior. With rising nationalism and new movements for independence and equality in Africa, Asia, and Latin America, racial disturbances in Little Rock, Arkansas, or Cicero, Illinois, have global impact. Americans are constantly reminded, with good reason, that racial or religious discrimination at home tarnishes the image of America abroad.

The primary objection to discrimination, of course, is moral. Whatever the status of our foreign relations, there can be no justification for the denial of anyone's right to be judged solely on his or her merit as an individual. The international aspects of the problem, dramatic and important as they are, merely reinforce the more basic moral issue.

Discrimination Must End

Less attention has been devoted to the powerful economic forces that further strengthen the movement to end discrimination. Nondiscrimination in employment is imperative on practical business grounds, aside from its moral and political values. Through the policy of "merit employment," by which workers are hired and promoted without regard to race, color, religion, national origin, age, or sex, employers serve both their own economic interests and the long-range goals of American society.

This article focuses upon the economic necessity for merit employment, the problems confronted and techniques used by employers in combatting discrimination, and, finally, the broad responsibilities of management in this area. It reflects the experience of managers in a wide range of industries, emphasizing the consistency between the immediate needs of business and the moral demands of society. Morality, law, and economics thus combine to compel the elimination of discrimination.

Economic Pressures

Economic pressure for merit employment comes from two sources: the labor market and consumers. There has been, for example, an extensive migration of minority group members, particularly Negroes, from rural to urban areas and from the South to the North and West. The percentage of the total Negro population living in Southern rural areas declined from 74 percent in 1900 to 14 percent in 1957, and over the same period the percentage in Northern urban areas rose from 7 percent to 43 percent. About 85 percent of the Negroes lived in urban areas, both Northern and Southern, in 1957. The percentage of Negroes in the total population dropped from 30 percent in 1900 to 19.5 percent in 1957 within the South, and rose from 2.0 percent to 6.6 percent within the North.¹

With an approximate doubling of the ratio of Negro to total population

in non-Southern areas between 1940 and 1960, the so-called "race problem" cannot be regarded as regional. While there is no doubt that the legal, political, and social basis for discrimination is strongest in the South, many in the North and West have been inclined to point accusing fingers in a Southern direction without taking positive and decisive action to meet the problem in their own areas.

Largely because of the accelerating migration of Negroes to non-Southern regions, and particularly to certain urban centers, the elimination of discrimination in employment has become urgent on economic as well as moral grounds.

Population Shift

The key factor from management's viewpoint is that minority groups form an increasing proportion both of the available labor supply and of the consumer market in the urban areas of the North and West. In Illinois, for example, the nonwhite population increased almost 70 percent between 1940 and 1950, while the white population rose only about 7 percent in the same period. From 1950 to 1955 the number of nonwhites climbed from 666,118 to 1,086,000, compared with a rise of whites from 8,046,058 to 8,275,000.

In Los Angeles County, nearly one quarter of the population consists of persons of Negro, Mexican, Jewish, and Oriental backgrounds. Between 1950 and 1956, more than one third of all those added to the population of the city of Los Angeles were Negroes. "Minority" groups now constitute a majority of the population of Washington, D.C.²

In Baltimore, Chicago, Cleveland, Detroit, Philadelphia, St. Louis, and Washington, the proportion of non-

whites to total population equals or exceeds the corresponding proportion in the South as a whole.³ The Puerto Rican and Mexican-American populations of New York City and Los Angeles, respectively, are increasing rapidly. In these areas, the businessman must recruit his workers from and sell his products or services to a market increasingly composed of members of minority groups.

As a result of these changes in the labor market, discrimination poses a sharp dilemma for businessmen as well as for the minorities which have been its immediate victims. Established employment patterns have largely restricted the members of certain minority groups, particularly Negroes, Mexican-Americans, and Puerto Ricans, to unskilled occupations. Yet the greatest demand for trained and experienced workers in the 1960's will occur in the professional and technical, and clerical and sales, occupations.

Significant increases in employment are also anticipated for skilled workers, proprietors and managers, service and semiskilled workers. The need for farmers and farm workers will decline, and the demand for unskilled workers will remain unchanged.

Labor Shortage

Unless discriminatory barriers are removed and increasing numbers of minority group members are effectively trained for the higher skilled jobs, the available supply of workers required for these jobs will fall considerably short of the demand in many areas. The problem of discrimination, therefore, should be of direct practical concern to management.⁴

The consumer market served by the firm is also a source of strong pressure

in the direction of merit employment. The businessman who numbers many minority group members among his customers may well be influenced to add employees from such groups to his work force.

Some firms with branches, however, employ these workers in "nontraditional" jobs only in those areas where much of their trade comes from one or more of the minority groups, and continue to discriminate in other areas. Obviously this is not genuine merit employment. The policy may nevertheless be ultimately fruitful if a successful experience with minority group employment in the nontraditional classifications leads to the adoption of nondiscrimination throughout the entire firm.

It Is the Law

Added to the moral and economic impetus to merit employment is the pressure of legal responsibility. The majority of businessmen outside the South are legally obligated to pursue nondiscriminatory policies. All firms receiving contracts from the federal government, for example, commit themselves to adopt merit employment, and a special agency—the President's Committee on Government Contracts—helps administer this policy in cooperation with the Compliance Officers of the respective departments.

Seventeen states, including all the populous states of the North and West except Illinois, have enacted enforceable "fair employment practices" (FEP) laws requiring employers, unions, and other organizations to drop discriminatory procedures. In addition, about forty communities have adopted some form of policy favoring nondiscrimination in employment.

Indiana and Kansas have established "voluntary" FEP commissions with machinery only for conciliation and persuasion. A number of states now have legislation requiring non-discrimination in firms holding contracts with the state, or commissions designed to promote greater interracial understanding in general.⁵

Problem Areas in Employment

Despite the confluence of moral, economic, and political forces favoring merit employment, it would be naive to conclude that the adoption and implementation of this policy present no problems to management. First, any change in the employment practices of the firm, whatever its nature and origin, may provoke some anxiety on the part of employees, supervisors, and customers. Those accustomed to an established practice will often tend to suspect and resist a deviation from the customary.

Second, and perhaps more important, the nature of racial or religious prejudice is such that at least some of the response to the introduction of merit employment may be irrational and emotional.

It is possible that human behavior is less rational in this aspect of life than in any other. Certainly the resistance of prejudice to reason and fact has often been demonstrated.

From management's viewpoint, a change in policy which challenges the stereotypes and prejudices held by workers, supervisors, and customers alike represents a bold step. Experience indicates that the anticipation of resistance is usually far out of proportion to reality, but many employers are still inclined to be cautious when dealing with problems of interracial group relations.

Various surveys suggest that supervisors and foremen are sometimes reluctant to accept merit employment because of the potential difficulties that they envisage. Thus, the normal resistance to change *per se* is accentuated by the emotional reactions or fears triggered by racial and religious prejudice.⁶

Most businessmen are practical and hard-headed in their approach to employment policy. While a son or a brother-in-law will sometimes be given opportunities for reasons other than individual merit and ability, the average employer can ill afford to allow strictly personal and subjective considerations to influence his selection of employees.

Difficulties Often Exaggerated

There are cases, however, where a manager or personnel specialist lets his private prejudices rule his judgment in business matters. A large public utility, in an area where other utilities have had outstanding records in implementing nondiscriminatory policies, has markedly lagged behind its fellow companies in this respect, apparently because certain top executives are prejudiced against non-whites.

Some employers and department heads frankly prefer men over women in particular types of jobs, without any necessary regard to their respective abilities. During World War II, some firms encountered powerful resistance from supervisors to the employment of women in jobs long occupied by men.

Aged and handicapped workers may be barred from work arbitrarily even though they are well qualified. Admittedly, employers sometimes reject such applicants not because of

prejudice but, rather because experience has indicated that they are not well fitted for available jobs.

Fellow Travelers in Bigotry

In many instances, the businessman personally is unconcerned about the race, religion, national origin, or sex of his employees, but responds to what he regards as the predominant attitudes of the community and his existing work force. He may be wrong in his estimate of the resistance to a merit employment policy, but he is reluctant to "stick his neck out." One of the most frustrating aspects of the problem of prejudice is its entrapment of many who are themselves unprejudiced. The bigots are joined by large numbers of "fellow travelers" who, for various reasons, feel that self-interest makes it expedient for them not to challenge bigotry.

The natural conservatism of many businessmen militates against the adoption of untested policies. There is little incentive to depart from the practices which have apparently worked well in the past. In large sectors of the economy, only a crisis of the magnitude of World War II precipitates the abandonment of tradition and the acceptance of new attitudes. Not many employers want to be pioneers, particularly in the face of potential community opposition.

Without question, the Negro is the foremost victim of discrimination in employment. Other groups, notably Jews, Mexican-Americans, and Puerto Ricans, encounter barriers, but seldom do they meet the resistance directed against Negroes. The Oriental has had increasing acceptance in industry and the professions in recent years, with virtual disappearance of discrimination in many types of jobs.

Prejudice Can Fade Fast

In California, a state not noted for its liberal treatment of Orientals in the past, white collar workers of Chinese, Japanese, or Filipino ancestry are now widely employed without difficulty, as labor statistics reveal. There is evidence that this once deeply held prejudice has faded from the thinking of the community in regard to the employment situation. This statement is based on evidence collected during 1960 and the opening months of 1961 when a number of employers in the Los Angeles area were interviewed in depth by the author on the subject of merit employment.

The survey was conducted under the auspices of the Institute of Industrial Relations at UCLA and included a cross section of executives and personnel specialists in Southern California firms of all sizes. Questions asked covered the entire range of experience with merit employment of the firms surveyed. They included policies followed by these firms, the degree of resistance encountered, experiences with minority workers on the job, the quality of their work and sources and methods of recruitment for minority group workers.

Some of the management spokesmen interviewed expressed surprise when the possibility of discrimination against Orientals at the present time was suggested. One Southern California firm, which met strong resistance when it employed Japanese-Americans immediately after World War II, now employs many Orientals, Negroes, and Mexican-Americans in a variety of positions. A businessman interviewed commented:

"For many years I observed a great deal of discrimination against Filipinos in industry. This declined after World War II when G. I.'s came home. Servicemen who had fought in the Philippines respected and admired Filipinos."

While discrimination in general has lessened recently, it often survives in subtle forms which make it difficult to detect and measure. Many firms hire only a token number of Negroes, Orientals, Mexican-Americans, or Jews—just enough to enable the employer to proclaim his lack of prejudice.

Token FEP

Some employers hire light-skinned Negroes or Mexican-Americans or Puerto Ricans, but reject those with darker skins (though this policy seldom persists over the long run). Many employ scores of minority group members in production and office jobs, but bar them from executive, administrative, or professional positions.

Even where a firm is prepared to experiment with merit employment, its progress is sometimes discouragingly slow, not because of resistance but simply because the employer tends to anticipate trouble which seldom develops. A representative of a community agency noted that:

"In our experience, when a firm hires a Negro for the first time in a nontraditional job, it often waits at least another year before hiring other Negroes, just to make sure that everything goes smoothly."

Paving Way for Minority Workers

Most employers having long experience with nondiscriminatory employment remark that the main problem is

in getting started. Once the policy is in operation, the firm merely follows its normal routine without variation and usually without incident. Employers questioned by the author are generally of the opinion that business firms should not depart significantly from their usual procedures in implementing merit employment, but most take a few precautions in the early transitional stages.

"Accept It or Leave"

The first requirement for a successful policy in large companies is that top management must be firm and unyielding in its support of merit employment. Supervisors and rank-and-file workers alike must clearly understand that management will not retreat from this position under any circumstance. One executive in a manufacturing concern stated a commonly held view:

"We make every effort to sell our employees on the values of nondiscrimination, pointing out that our customers are of many different races and creeds. But if an employee or a supervisor says he will not work with a Negro or any other minority group member, we simply bid him goodbye. There is no place in the firm for this kind of person."

It should be noted that the firm does not inquire into the private feelings of its employees or insist that each one personally approve of its policy. The sole requirement is that every employee, whether supervisory or rank-and-file, must abide by the company's rules while he is on the job.

Merit employment is similar to all other managerial policies in this respect; if the individual employee finds that he cannot tolerate any of the conditions under which he must work,

his only alternative is to leave the job.

If the experience of several prominent Southern California firms is typical, the employer need not fear serious resistance to his policy. The employee or supervisor who quits his job, or even threatens to quit, is a rare phenomenon.

A supervisor may sometimes express anxiety over the reaction of his subordinates to the presence of a minority group member in the work group for the first time, but difficulties seldom arise after the step is taken. The executive of a leading communications firm described the reaction he observed this way.

"When we placed our first Negro employees, the supervisors in the various departments were called in and given a briefing. In these early meetings, when the policy was still young, some department supervisors thought that there might be resistance and adverse reactions. But no trouble ever developed. In fact, in at least one instance the people in the department were most concerned about the feelings of the Negroes newly hired, and went out of their way to make sure that the Negro employees felt accepted and comfortable. Our experience has been that once a Negro is hired and on the job, no problem arises because the quality of work performed by the Negro dispels any doubts."

Soon Accepted by Professionals

The readiness with which Negroes are accepted by the existing work force will, of course, differ somewhat from one group to another. A research and development organization finds that its professional staff accepts Negroes and all other coworkers from minority groups on a basis of com-

plete equality, with no discrimination either for or against such workers.

In this intellectually high-powered unit, the Negro is judged strictly on his individual ability. But in the shop and service areas of the firm, which have a high proportion of women from Southern and border states, some resistance has occurred.

Another organization in the same field has appointed a Negro scientist as head of one of its major departments. In a sharp reversal of "roles," a division of the firm employs several Negroes on its professional staff and none among its custodians, not by conscious design but simply in accordance with its usual policies of merit employment. Racial and religious prejudice is rarely manifested by scientific and technical personnel with advanced academic training, and a fully qualified Negro is likely to be accepted in such a group without discrimination either on or off the job.

Firms differ in their degree of preparation for the entrance of minority group members into their work force. Most employers interviewed emphasized that the first Negroes hired in a particular group were screened with extra care, often to insure that workers with especially agreeable personalities were obtained. There is unanimous agreement that, following these initial placements, the firm should maintain the same hiring and orientation procedures for all prospective employees regardless of race or religion.

"Sell" Supervisors on Idea

Department heads and supervisors normally are consulted before a Negro worker is initially placed in their group. Some firms will not proceed with Negro placements in a depart-

ment until full and willing cooperation from the supervisor is forthcoming; other firms, however, merely inform him of the company's policy and expect him to carry it out. If he does not, he is fired.

The executive of a major financial institution has stated: "We always make sure that the branch manager and supervisor are sold on the idea of nondiscrimination before a Negro is placed in a nontraditional job. No particular effort is made to sell the policy to employees as a whole. If resistance develops, we are prepared to deal with it promptly and firmly, but none of any importance has yet appeared."

An executive of a transportation firm described the policy of his company when Negroes were first placed in nontraditional jobs:

"We held informal meetings with supervisors, explained our policies, and distributed copies of *Why?*⁷ a booklet on merit employment issued by the National Foremen's Institute. The company went out of its way to get particularly well-qualified Negroes, all of them college graduates. Now, of course, we just follow our regular procedures."

Two to Break the Ice

The personnel director for a public utility commented:

"The usual procedure is to get the feeling of the people involved before embarking on a new policy affecting them. When a Negro was introduced into the work force for the first time, the supervisor was told in advance and he in turn would tell the group that a Negro was coming in. In the earliest phase of Negro employment, company policy was to hire two or more Negroes in each work group so that the new employee would not have a feel-

ing of isolation. Merit employment is now so well established throughout the firm that no special policy is followed."

In dealing with resistance from department heads and supervisors in the early stages of Negro employment, the personnel executives of a large manufacturing firm found it useful to talk informally with the resisters and compare the respective job qualifications of the Negro and white applicants. They would concentrate on specifics, intent only on demonstrating the superior aptitudes of the Negro for the job in question.

These are large firms, most of them with a long history of merit employment. Undoubtedly the problems connected with the employment of Negroes and other minority group members are more severe in the small firm, where the employer often tends to comply with the dominant attitudes of his employees. The experience of one employer in a small firm, however, would seem to suggest that the proper approach to this problem is not much different from that pursued in the larger firm. He said:

Job Performance Is What Counts

"If, for instance, we were considering hiring a Negro girl as an assistant to the bookkeeper, I would go to our bookkeeper and talk to her about it, trying to get her complete cooperation. If she were reluctant, I would tell her: 'Let's just try the Negro girl and see what happens.' Once the Negro is put on the job, everything usually turns out all right. It is important to get extremely efficient and personable Negro employees for the initial placements."

The most common experience in industry, at least in non-Southern

areas, has been that little or no overt resistance arises after the minority group member has been put on the job. This may be due in part to the careful selection of the initial placements, whose excellence immediately dispels anxieties and counteracts stereotypes.

Once the other employees become fully accustomed to working with Negroes, Jews, Mexican-Americans, and others, it is likely that future job-holders from these groups will be treated more as individuals, and the need for extra care in screening and placement will decline correspondingly.

"Difficult" Straw Bosses

Nevertheless, even a firm with long-standing merit employment policies will occasionally encounter discriminatory actions by department heads, foremen, and other lower-level supervisory personnel. Where a minority group member complains of discriminatory treatment, one manufacturing firm deals with the grievance in a unique way:

"We have an older employee, leadman, supervisor or professional person from the same minority group, if possible, talk to the aggrieved worker and try to determine if his grievance has merit. In our opinion, the worker is more likely to be frank and open with a member of the same group (though admittedly there are cases where this is not true).

"Our policy is to avoid discriminating either for or against the minority group worker. If he is unsatisfactory as an employee, we do not hesitate to fire him. However, some employees from such groups are extra sensitive, and sometimes we will take additional time and care to investigate a com-

plaint, in order to make clear that no discrimination exists, even though ultimately we have to discharge the worker."

Bars to Advancement

Complex problems arise with respect to the advancement of Negroes to higher-level jobs. The informal and unofficial organization of the work group can lead to effective discrimination even though the formal policies of the firm are beyond criticism.

For example, a Negro may not be given the kind and quality of assignments which would enable him to demonstrate his competence or leadership capacity. The discretion necessarily exercised by the foreman, and often by the senior members of the group, leaves room for *sub rosa* discrimination which prevents the Negro from making his case for advancement.

The type of subtle discrimination which may exist in a closely knit group is particularly difficult to overcome. A tacit agreement among certain key leaders in the unit can assure that a Negro never performs work above a minimum level of skill and responsibility. An alert management, therefore, must inquire into those informal practices which often defeat the purposes of its formal policy.

Most employers interviewed reported no significant differences in quality of work between white and nonwhite employees on the same job. One executive commented that, at least to some degree, he prefers white collar job applicants from minority groups simply because they must have unusual motivation and ambition to overcome the added obstacles in their path. On the other hand, a few instances (not necessarily typical) were

reported in which the rate of turnover for nonwhite workers was somewhat greater than the corresponding rate for whites.

Craft Barriers

The executive cited above has noted that, in his experience, Negroes tend to apply most frequently for unskilled or for white collar and professional jobs. He has observed a marked scarcity of Negro applicants for skilled craft jobs, though there is a need for trained workers in this area.

This deficiency is partly the result of discriminatory policies pursued by certain craft unions, which through a variety of methods have restricted the entrance of Negroes into many of the skilled trades. It also reflects the aspirations engendered within the family and community.

The chief problem in many firms is that the advancement of Negroes, Mexican-Americans, and other minority group members is often limited by inadequacy of training and qualifications. In view of the growing proportion of minority groups in the labor force, businessmen would do well to devote greater attention to this problem.

Need Training Opportunities

The solution lies not only in expanding educational and apprenticeship opportunities for such groups but also in redirecting vocational goals so that the younger members recognize and train themselves for opportunities that exist.

The long-existing pattern of discrimination in employment has discouraged many minority group members from seeking other than "traditional" jobs. Further, parents and advisers may fail to provide the early

guidance which leads the youngster into the courses most useful to him in preparing for a career. Even if he aspires to the "nontraditional" job, he may confront counter pressures within the family or the minority community. These and related factors depress the level of job aspiration and the quality of training obtained.

The statement of one leading personnel executive is typical of many that were made to the author:

"In this firm, we have jobs available that could be filled by minority group members immediately if they were sufficiently qualified. For the most part, we have succeeded in overcoming any effective resistance to employment of Negroes, Mexican-Americans, Orientals, and others; the problem now is to find trained applicants for skilled, technical, and professional jobs."

Communicating Merit Policy

Most firms prefer an indirect and informal communication of their non-discriminatory policies to employees and the general public. Some employers publish personnel manuals or handbooks which explicitly set forth these policies, but aside from this practice most of them are reluctant to make an issue of merit employment. A number of companies use their own newspapers or employee bulletins to call attention to awards given executives by the Urban League or other organizations interested in combating discrimination.

Several convey a subtle message through publication of photographs showing interracial work groups, company athletic teams, or social activities. A major aircraft company shows all new employees an orientation film

which has shots of interracial groups in various departments, without explicitly mentioning its nondiscriminatory policy.

The extent to which the policy is made explicit will depend largely upon the nature and location of the firm and the requirements imposed by government agencies. Companies with long-standing merit employment practices and frequent job applications from minority group members seldom find it necessary to spell out their policy, while others may go out of their way to encourage applications from those who will not otherwise know that nontraditional jobs are available at the firm.

The Role of Geography

Geography plays a significant role at times: some firms are located so far from minority group residential areas that they normally interview few, if any, applicants from such groups. Here, as in other aspects, the problem of discrimination in employment cannot be separated from the broad problem of housing segregation and racial discrimination in the community as a whole. It goes without saying that there are certain areas in which community resistance to nondiscrimination is powerful.

Employers should be aware that the state and local "fair employment practices" commissions and the President's Committee on Government Contracts often encourage written statements of the firm's nondiscriminatory policies, as evidence of its good faith. It is wise practice to inform private employment agencies and other recruiting sources that the company does not discriminate on grounds of race, color, religion, national origin, age, or sex.

An Overall View

Most employers view their merit employment policy as a complete success. Not all follow the same route, however. Some proceed rapidly after a favorable experience with the initial placements; others move slowly and deliberately even though they meet no apparent resistance. When questioned, each felt that in retrospect the correct course had been pursued. One management spokesman stated frankly that nondiscrimination had not yet been adopted in all departments of the firm, but that in general progress was being made. The most common response was that the company proceeded somewhat cautiously in the early stages, but accelerated the pace when it encountered no problems. Any special procedures were soon abandoned.

What Employers Can and Can't Do

In his implementation of merit employment, the businessman may confront the practical dilemma often faced by those working in this field: Does a special or unusual policy affecting a minority group itself constitute "discrimination" even though it is intended to facilitate the employment of members of the group? While there is no universally applicable answer to this question, experience suggests the following guides:

- Any sort of special treatment, whatever its nature, is undesirable in principle and should not be regarded as ideal in the long run. The ultimate goal of management should be to attain complete equality in employment conditions and opportunities for all workers regardless of race, color, creed, or similar factors.

- It is unrealistic to ignore the pervasiveness of discrimination in present American society and to pretend that it does not exist. The employer cannot remain blissfully unaware of the barriers encountered by particular minority groups in other parts of the community. His attention to the problems of minority group employment will be in proportion to the degree of prejudice manifested by his other employees, his customers, or the community as a whole. In giving special consideration to such problems, the employer does not engage in or condone "discrimination" but merely recognizes its existence and the need for procedures to combat it.
- These principles require flexibility of approach in the implementation of merit employment. Any special procedures used in introducing minority group members into the work force, or in handling their grievances, should be informal, unpublicized, and preferably, temporary.
- Since the employer ultimately will want to abandon these procedures, it is unwise to give them official recognition and status. As a general rule, no deviation from the normal routine should be permitted unless it is considered essential to the success of the non-discrimination policy.

Avoid Discrimination in Reverse

No hard-and-fast rule applies to all work groups. In some groups, such as scientific and technical personnel, special procedures will not be necessary and would, indeed, be highly

inappropriate. In others, a great deal of planning and orientation may be needed before merit employment is successfully launched. This is a judgment which can only be made by management in the light of its knowledge of the workers involved. All short-run decisions must rest upon an awareness that in the long run no employee should be accorded special treatment of any kind because of his race, religion, or similar factors.

Above all, the employer must not risk creating problems through the adoption of procedures which focus excessive attention upon the employment of particular minority group members. Precautionary measures will normally be limited to the time when such workers are first introduced in a given department or type of job, and abandoned when merit employment is no longer an innovation. In an area with a background of strong racial prejudice, however, the employer may find it necessary to proceed cautiously for a longer period of time.

In regions such as Southern California, the adoption of merit employment in a large firm seldom engenders serious resistance. Association among different races, nationalities, and religious groups is not uncommon within the area, and only a firm stand by management is required to make the program effective. Some companies have found it helpful to work with community organizations such as the Urban League and the Personnel Relations Bureau of the Jewish Federation-Council of Los Angeles.

The experience within small and medium-sized firms is more difficult to judge. It is probable that racial discrimination is rather firmly entrenched in this sector, and it is rare to find a Negro employed in a non-

traditional job (particularly one requiring contact with the public).

Problems of Small Firms

Employers are reluctant to experiment, even if otherwise inclined to do so, because they have a small and usually homogeneous work force, serve only a limited segment of the community, and often do not provide the wages and fringe benefits offered by the larger companies. They may anticipate, therefore, that the employee or customer who objects to nondiscrimination is more likely to go elsewhere, and his loss will be more keenly felt than in the large firm.

In all probability, most small employers have never given thought to this problem, and would be astounded if a Negro were even to apply for a nontraditional job. A small businessman interviewed by the author, however, reported that his own experience with merit employment had been favorable and that the policy in other firms of his acquaintance had been equally successful.

Discrimination in the small business sector undoubtedly merits much attention from FEPC and other agencies. Ironically, it would appear that a significant number of complaints are sometimes filed with FEPC against firms with long-standing merit employment policies. This apparent paradox arises from the fact that these firms interview and employ a greater-than-average number of minority group members, and therefore confront the probability of more complaints based on alleged discrimination.

Firms which never receive an employment application from a minority group worker will not be involved in complaints, even though they may be

highly discriminatory. In this sense, complaints filed are not a reliable index of discrimination; indeed, under certain circumstances there may be an inverse correlation.

For these reasons, FEPC, the President's Committee on Government Contracts, and other agencies must investigate those segments of the economy (particularly the smaller-sized firms) in which discrimination is so traditional and accepted that minority group members instinctively avoid them.

Positive Approach Needed

Clearly, the elimination of discrimination is urgent on all grounds—moral, economic, and political. It is not enough, however, for any leader in the community (whether in business, organized labor, the professions, education, or government) merely to say that he personally does not discriminate.

The employer who proclaims his sincere willingness to hire qualified job applicants from minority groups is deserving of praise, but his responsibility does not end there. The factors which may cause a shortage of such applicants in his employment office are also his concern; failure effectively to communicate the company's non-discrimination policy, housing segre-

gation which forces minorities to reside many miles distant from the firm's location, inadequacy of training and vocational guidance for such groups, and restrictions imposed by unions or professional associations. If the businessman, with his key role in the community, does not interest himself in these problems, their solution will be difficult and, as a result, the qualified applicant may never show up.

This illustrates the importance of a positive and broadly-based approach to the problem of employment discrimination. From the viewpoint both of government and of business, it is not enough to deal with specific instances of discrimination as they occur.

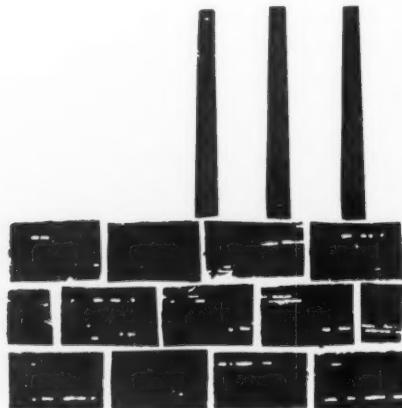
The vast manpower resources represented by minority groups will not be fully mobilized until the whole problem, in all its aspects, is faced boldly, in the sense that adequate education and training, vocational guidance, housing, and other requirements of the effective and well-motivated worker are everywhere provided.

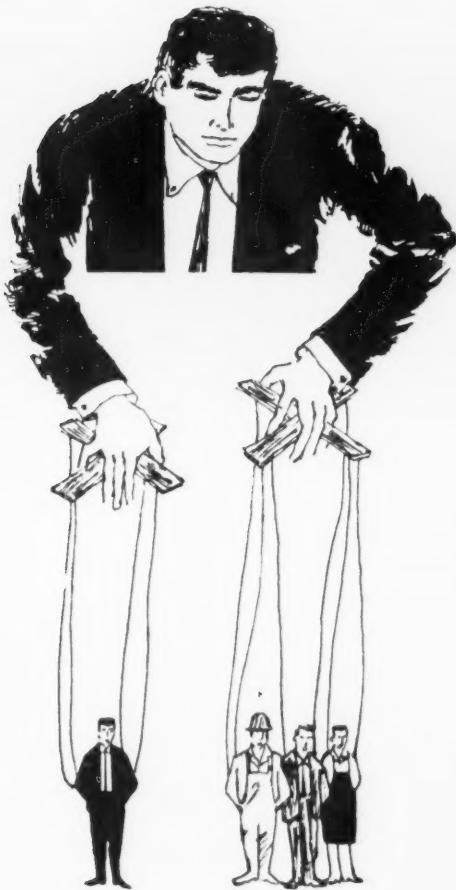
Discrimination in employment can ultimately be eliminated only by striking at its source: the social and economic pattern established in the community. The manager shares in this vast responsibility.

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3. See note 1.

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THE MYTHICAL PERSONNEL MANAGER

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Everyone thinks of him as a staff man who serves management in an advisory capacity, but he is, in truth, an executive with very real and far-reaching powers. Though he may manipulate men and policies with the velvet glove of persuasion, the iron hand of authority is there as this article, which analyzes his complex role in the factual terms of job performance, reveals.

The personnel man as described in textbooks and journals is like the Abominable Snowman—much talked about but seldom seen. Traditional usage would lead us to believe that the personnel man is a "staff" man—that is, an official with advisory and

consultative rights, but advisory and consultative only, who performs certain "service" activities.

In our opinion, this is far from the actual case. The word "staff" simply does not fit what the personnel manager is and does. As Hayakawa would

say, "The map does not fit the territory."¹ Use of the word "staff" is symptomatic of a general misconception of the personnel manager's role.

The Myth

In this article the activities and position of the personnel manager are examined in terms of the kinds of influence and authority exercised by him. The position discussed is that of the chief personnel officer of a company, whether he be called a vice-president, personnel director, director of industrial relations, or any of a number of other titles. Various personnel functions are examined in order to portray his role more accurately.

Before looking at the "real" personnel manager, however, let us review some typical definitions of the word "staff" when this word is used in describing personnel and industrial relations, for much of the myth of the personnel manager revolves around this concept.² McFarland, for example, defines staff as being "devoid of the right to command or to veto." And he goes on to refer to the personnel function as a staff function.³ Myers and Turnbull describe staff as "advice-giving" and repeatedly use the word in describing industrial relations in contrast with "line" departments.⁴

Sayles and Strauss define staff as designating "a group in the organization that is not charged with the responsibility of getting the work done—as distinct from line departments."⁵

Mee and Williams say "As the personnel department is conceived as a staff unit, there is seldom any operating or line authority for final decisions delegated to its people other than for internal personnel department affairs."⁶ It is clear that McGregor has a "staff" concept of personnel admin-

istration, although he takes note of an occasional delegating of personnel administration responsibility to the "staff," a practice which he deplores.⁷

And so it goes. Personnel departments tend to be referred to as staff, and staff traditionally is defined as advice-giving. To say that the personnel department performs an auxiliary function cannot be denied, but to refer to it in terms meaning advice-giving, and to ignore other aspects, we think, departs substantially from reality.

Is He Strictly Staff?

Some authors who define staff as advice-giving, and who refer to the personnel department as being "staff," ignore their own definitions by describing personnel administration in practice as being something quite different. For example, Myers and Turnbull use the term "staff" in talking about personnel functions, yet carefully document that a great deal of effective decision-making often rests with the personnel officer.

In referring to interviews conducted with personnel executives, they note, "One of the most striking results of the interviews was the contradiction between belief and practice . . . the typical response was that he operated in the staff capacity or, at most, in some combination of staff and line capacity. But when he went on to describe how he handled particular personnel or labor relations functions, it was clear that in a number of situations *he made the effective decisions*."⁸

Saltonstall⁹ also contradicts himself. He starts out by saying that the personnel director exerts implied authority and functional controls as well as performing advisory activities. He concludes, however, by classifying the division of responsibility between

"staff" and "line" in such a way as to imply that the personnel director has little or no authority. He uses words like "develop," "consult," "plan," "interpret," "evaluate," "diagnose," "research," "investigate," and "recommend," with reference to personnel people; and such words as "direct," "control," "decide," "enforce," "apply," "perform," and "instruct," in referring to the responsibilities of supervisors in departments other than personnel.

Although Saltonstall has made a contribution in shedding some light on the role of the personnel executive, we do not believe that he goes far enough in documenting the authority typically found in that position.

It Isn't Necessarily So

There are, however, a few organization theorists whose theories, we believe, can readily be applied to personnel management. For example, Stahl asks . . . "would it not make sense to divest ourselves of the abracadabra that divides 'line' and 'staff' into incongruous kinds of activity and to recognize that *all* such activities are simply specialized subdivisions of that organization's work?"¹⁰

He goes on to say: "I find it convenient to think of the work of an enterprise as a network, a grid, or a checkerboard in which vertical program subdivisions are interlaced with horizontal sustaining activities. The chief executive sits in a position at a top corner from which he holds both the vertical lines and the horizontal lines."¹¹

Applying his conceptual scheme to personnel administration, we find the personnel director involved in the development and control of the framework or the boundaries within which program operators must perform—

particularly the framework and boundaries pertaining to the quality of the treatment of people and the procedures used to assure equity and control.

Urwick¹² lends support to this view: "This staff relationship is at present very imperfectly understood and applied in civil life. It has been suggested . . . that a 'staff' officer's position should be 'purely advisory.' This suggestion is an escape. The phrase 'purely advisory' is usually an attempt to avoid personal misunderstandings and clashes of authority due to inability on both sides to form a clear picture of a correct position. But it is equally obvious that a subordinate who merely adds to the numbers of advisors cannot do much to relieve a chief of an increasing burden and complexity of command and particularly in the work of coordination."

Network of Authority

Anderson's¹³ functional executive is similar to the military "staff" officer concept of Urwick and is also consistent with Stahl's concept of the "network of authority." Anderson says in effect, that the line officer rarely has full authority and that functional officers (of which the personnel officer would be an example) typically exercise controls over certain aspects common to the various line units.

This is the way he puts it: ". . . As soon as the first step is taken toward dividing up the work of the enterprise into operating units, there must be initiated some method of getting the divided parts or units back together again into an integral whole . . .

". . . The managers or supervisors of such units find accordingly their spheres of activity diminished and their independence curtailed, and

since the chief executive, due to limitation of his span of attention and control, cannot personally supervise all the activities necessary for coordination and control, his only recourse is to appoint special assistants for the task . . ."

Stahl, Urwick and Anderson, then, provide a useful framework for thinking about the role of the personnel director. All three talk about controls and authority exercised by what are often labeled "staff" people. We think the personnel director is a case in point.

Basic Thesis

Here, then, is our central thesis: In addition to advice-giving and directing the work of his own subordinates, the job of the corporate personnel director involves a type of functional authority which is exercised horizontally and down throughout the entire organization, and that this authority can only be understood by examining the subcomponents of major personnel functions. The word "staff" with its connotation of advice-giving glosses

over the personnel director's role and either ignores or denies major parts of it. We will first cite what we think are appropriate tests of authority, and then try to show how the personnel manager meets these tests.

Influence or Authority?

In reality, is the personnel manager influential or is he authoritative?¹¹ We submit that there are two tests of authority which will help us answer this question. The foremost of these is that there must exist the institutionalized right to limit choice. A secondary test and one which by itself does not suffice is that the recipient of an authoritative communication "holds in abeyance his own critical faculties for choosing between alternatives."

In order to understand and to utilize these tests of authority in our analysis, it is first necessary to examine the nature of authority and power as contrasted with influence. Figure 1 gives this comparison in a summarized fashion.

POWER
Is the ability to limit choices for social action.

Coercive.
Based on inequality.
May or may not be formalized or institutionalized.
If institutionalized, is referred to as "authority."
When in the form of authority attaches to a position.
When in the form of authority, involves rights—the right to command, to limit choice.

INFLUENCE
Is the ability to cause others voluntarily to choose alternatives favored by the influencer.

Persuasive.
Always informal.
May exist either within or outside a formal organization.
Based on free choice and perceived superiority of the alternative chosen.
Attached to ideas, doctrines, persons.

Authority is institutionalized power. The existence of authority in an organization results from conscious efforts to structure power relationships between people. We artificially assign extra power in the form of authority, to certain positions whose occupants will hopefully use this extra power to further the goals of the enterprise. Thus, we create what is in a sense an artificial power inequality.

Authority usually involves the ability to broaden as well as to limit choices. Thus, we speak of someone having authority to grant a subordinate a pay increase. This ability to broaden choices results in applications of authority that are sometimes more subtle than mere restrictions of choice which are negative in character.

To illustrate, it is quite obvious that a foreman is limiting choice when he says "Do this job, or draw your pay." It is much less obvious that choices are being restricted when he merely refrains from giving a promotion or a transfer.

"That's An Order"

There is another aspect of authority that helps us to recognize it. Where authority is manifest, the recipient of a communication "holds in abeyance his own critical faculties for choosing between alternatives."¹⁵ A person who receives an order does what he is told, suspending his judgment about other courses of action (provided, of course, he chooses not to challenge the authority of the communicator as we shall point out).

We have now suggested two conditions which indicate the presence of authority. The most critical of these is the institutionalized right to limit choice. The second is that the com-

municatee holds in abeyance his own critical faculties for choosing between alternatives.

Where both conditions prevail, authority undoubtedly exists. Where the former condition exists alone we submit that authority exists even if the recipient of a communication questions the directive or refuses to obey.

Chester Barnard and other theorists argue that this makes the authority nonexistent, a point of view with which we take issue.¹⁶ However, using Barnard's acceptance theory of authority one still comes to the conclusions set forth below.

Limitation of Choices

Where only the suspension of judgment about alternatives exists, authority is absent. Many people in an organization are technically expert and their suggestions are often accepted and acted upon uncritically. But if the technically expert persons lack the right to limit choices of the communicatee, the situation is either one of influence (where the communicatee *could* choose freely if he wished) or one of power (where the communicatee is coerced but the communicator lacks the *right* to limit choice).

Influence vs. Authority

How does the personnel manager fit into this authority-influence picture? Is he authoritative? Is he influential? Is he both? We are convinced that he is both.

He is influential, of course, because he accomplishes much through persuasion, but we submit that typically, he also has authority. Let's look at the personnel manager's activities, using the two criteria mentioned above—limitation of choice and communi-

catee's suspension of judgment about alternatives.

Does the personnel manager have the right to limit choice? Here we think the answer is an unqualified "yes." Typically, the personnel manager is given functional authority—the right to determine and enforce many personnel methods, procedures and policies. (Like all other executives, sales, finance and production included, there are some policies he will determine unilaterally, some after consultation with peers, and others will be submitted to the president for approval.)

The personnel manager's functional authority is a broad authority in the sense that it covers all, or almost all, departments of the enterprise, and it is a narrow authority in the sense that it is restricted to personnel policies, procedures and methods. Where the personnel manager is given functional authority (that is, the right to determine and/or enforce personnel procedures, methods, and policies), he has the right to limit choice.

The production manager, the foreman, the sales manager, and the purchasing agent may no longer determine individually what personnel practices will be within their respective departments—there has occurred a "reduction or limitation . . . of alternatives to the social action of one person or group by another person or group." This has come about by virtue of the rights granted to the personnel manager.

"But," it is often said, "the personnel manager really is just acting for the president or general manager, and he has no authority in his own right." We consider this a spurious disqualification—cannot the same be said of the sales manager and of the production

manager? Yet their "authority" is unquestioned.

He Limits Action

The personnel manager limits choice in every instance when he exercises the functional authority granted to him by his superior. He does this when he directs that no person shall receive a pay rate in excess of the rate range allowed for his job. He does it when he directs that employees are not allowed to smoke on the job, are not allowed in restricted areas, or will not have access to confidential files. He limits choice when he directs that all new employees must undergo indoctrination procedures, and executives must follow procedures established by him in the discharge of personnel.

The second test of authority we have posed is the uncritical reception of a communication without reference to alternative courses of action. How does the personnel manager meet this test? We submit that typically his communications are accepted without overt challenge; that his order is not treated merely as one of the evidential bases for making a choice; and that the recipient of the order does indeed "hold in abeyance his own critical faculties for choosing between alternatives."

He Gets Compliance

The foreman who receives a notice that merit ratings for his department are due in the personnel office on July 1 does not say to himself, "Well, that is a pretty good suggestion, but there are alternatives to doing it this way, and I'll just mull this over and make up my mind about its feasibility later on." More likely the foreman says, in

effect, "This is what I've been told to do so I'll do it."

Can't Fire Dissenters

But what happens if he *doesn't* do it—when he refuses to carry out the directives of the personnel manager? If a subordinate challenges the authority of, say, the sales manager, he may be dismissed or otherwise punished. Are there similar sanctions open to the personnel manager? He may not discharge the person challenging his authority, for his functional authority covers only the establishment of policies, procedures and methods and does not include the right to fire (except, of course, in his own department).

But, He Can Block Raises

However, there are other ways in which he may limit choices of those who refuse to conform to his directives. He might, for example, just refuse to approve pay raises for those persons whose merit ratings were not received at the time and in the form indicated, to use the example cited above. Or, he might decline to place on the payroll the names of those employees who were hired in violation of procedures he had laid down.¹⁷ Choice limitations such as these are likely to bring about conformance.

Punitive choice limitations such as those just mentioned, however, may be temporary. Sooner or later the personnel manager's right to take such punitive action will be challenged. When conflicts of this sort arise they must be resolved either between the disagreeing parties or by a superior executive, usually the president.

At this point the president has to make a decision about preserving his organizational integrity. How much

value does he place on functional organization as a way of doing business? How valuable is it to him to have the specialist actually give the orders, actually determine the methods, procedures and policies, rather than merely giving advice?

There are many other factors involved, of course, but ultimately this is the decision the president must make. Much can be done to minimize these potential conflicts, not properly the subject of this writing, but the potential will always exist as long as functional units such as the personnel department are used.

He Writes "Directives"

Even in the absence of punitive measures such as those mentioned above, the personnel manager has authority. He has the right to limit choice, and his communications are generally accepted uncritically. True, his authority is subject to challenge. But so is all authority in a democratic society. The sales manager's authority can be questioned. Even his right to take punitive measures can be questioned—it can always be appealed to higher levels in the organization. The personnel manager's authority's being subject to challenge does not make it nonexistent.

We think it can be shown conclusively that the personnel manager (1) limits choice, (2) has a right to do so, (3) has his communications received, interpreted, and implemented while the recipient's "own critical faculties for choosing between alternatives" are held in abeyance.

In Figure 2 the personnel director's role is analyzed in terms of the authority he uses as compared with the influence he exerts. The reader will note that it does not suffice to

FIGURE 2
EXAMPLES OF AREAS OF AUTHORITY AND PERSUASION FOR THE PERSONNEL MANAGER

AREA OF AUTHORITY		AREA OF PERSUASION	
FUNCTION	MAXIMUM USE OF AUTHORITY	COMBINED USE OF AUTHORITY AND PERSUASION	MAXIMUM USE OF PERSUASION
Salary Administration	 Direction of payroll calculations Establishing and administering job evaluation system Establishing and administering wage and salary plan Exemption ruling	Inter-departmental data gathering	Salary changes under rules of plan Applying job evaluation factors to a specific job
Performance Review	 Establishing and administering performance standard systems and plan, and merit rating	Orientation procedure	Changing recommendations about a specific individual under plans
Training, Orientation, Management Development	 Recruitment program Rejecting candidates Establishing beginning salaries and pay grades	Determination of number of participants in a training program	Determining who will attend advanced management seminar
Hiring and Recruitment	 Making area "off limits" until hazardous material is removed	Employment of individuals recommended by personnel department	Which foremen attend off-hours safety conference at University
Safety and Health Program	 Administration of discipline procedure	General housekeeping, removal of dangerous objects from work areas	Initiating discipline
Discipline	 Transfer rules	Establishment of discipline procedure Whether disciplinary layoff will become discharge	Transfer of individuals under rules of system
Transfer			

FIGURE 3

TYPICAL AUTHORITY AND COMMAND STATEMENTS

Function	Typical Command Statement
Wage Policy	"Time off with pay because of tornado warning will count as time worked for computing overtime."
Wage and Salary Administration	"Salary recommendations under the salary plan are due _____. You are not permitted to exceed the limits of the ranges of the plan under any circumstances."
Exemption Rulings	"Mr. Jones is now exempt under the Wage-Hour Laws and will no longer fill out a time sheet. He will draw straight time for any scheduled overtime. Incidental overtime will not be paid."
Merit Rating and Performance Standard Procedures	"No more than 25% of your employees may be placed in the 'superior' category." "Performance standards must be worked out between subordinate and superior with concurrence of higher authority." "The following format is to be used."
Recruitment and Screening	"This man will not be invited to the plant." "We are going to visit _____ College this year and try to recruit some of their graduating physicists."
Orientation Procedure	"All newly hired employees will attend an orientation meeting at 10:00 in the cafeteria the Monday following the day they report to work."
Establishment of Beginning Salaries	"If we hire this girl, in view of her experience, skill, and the pay plan, her beginning salary will be \$350.00 per month."
Safety and Health Program	"All employees entering room 30B must wear respirators until repairs can be made."
Administration of Benefit Plans	"Issue a check for \$40.00 to Mr. Olson to cover cost of X-rays at XYZ clinic."
Discipline Procedure	"You may put a man on immediate disciplinary lay-off pending a review of his case, but you may not unilaterally discharge him without personnel review."
Termination Procedures	"All terminating employees must pick up their checks at the personnel department and be interviewed."
Transfer Procedure	"Except in unusual cases senior employees are not to be made available for transfer because of technological change. The least senior employees are to be made available for transfer. You cannot transfer Mr. Smith."
Confidential Records	"I am sorry. We do not disclose that information."
Testing Procedures	"No one, including department heads, may see the results of the testing validation sample just completed."
Compliance with Federal and State Laws	"That would be a violation of state wage-hour laws, and as a matter of policy, this company is not going to violate these laws."

look only at broad functions of personnel administration, such as salary administration, or hiring or recruitment.

He Administers Pay Plans

Rather, these broad activities must be subdivided in order to determine more accurately the role of the personnel executive. For example, we find the personnel director having a great deal of authority in establishing and administering wage and salary plans, but that in making actual salary changes for specific individuals, the department head involved has considerable latitude—as long as he stays within the limits established in the plan. Within these latter limits, therefore, the personnel director can only use persuasion in accomplishing his ends.

Figure 3 is essentially a continuation of the first two columns of Figure 2, and lists various broad functions and typical command statements (stripped of pleasantries) which the personnel director might make. Such command statements are often couched in persuasive terms, but this does not change their authoritative nature.

His Reach Is Company-wide

An observation of these two charts will show that the personnel manager exercises functional authority as we have previously defined it—namely, the right to determine methods and procedures and policies for personnel activities throughout the firm. (To be sure, he may seek the support of the president and a few major executives, as may any executive when making changes of major consequence.)

This functional authority is characterized by being specialized—it is

limited to *personnel* activities—and by being comprehensive—it covers all or almost all of the units in the organization. As is seen in the preceding charts, his authority is so closely intertwined with the authorities of other department heads that they have, in effect, shared authority; for example, the determination of specific pay rates within the various pay ranges as previously mentioned. But this in no way refutes the contention that he does indeed have authority.

His Relations with the President

We can tell something more about how much authority the personnel manager has by looking at his relationship to the president. The president may delegate important policy-making and planning authorities to him, or he may delegate only relatively minor authorities dealing with procedural matters. The most important kinds of decisions usually have something to do with planning—with setting down future courses of action.

If the personnel manager makes important planning decisions it can be shown that he is more authoritative than if the president makes all the planning decisions and the personnel manager is left only to carry out the plans.

Figure 4 lists various alternative hypothetical situations. The left side of the figure indicates a situation in which the personnel manager makes few important decisions. His only real function here is to prepare the plan for his superior's approval and then to make routine decisions about its implementation.

In the center category we find him performing all of the steps in planning and implementing with the exception of the critical decision on

FIGURE 4

EXERCISE OF AUTHORITY IN PLANNING, DIRECTING, AND CONTROLLING OF PERSONNEL ACTIVITIES

ABEA OF AUTHORITY USE BY SUPERIOR

Superior sees problem and personnel manager perceives problem and need for plan, approves unneeded for plan, directs personnel manager to draw up plan, undertaking of planning. Personnel manager performs own data gathering and other intermediate steps in planning, superior approves final plan; personnel manager implements plan, makes routine decisions, makes nonroutine decisions after consulting superior.

Personnel manager perceives problem, sees need for plan, undertakes planning, performs intermediate steps in planning, approves final plan, implements plan, informs superior, implements plan. Superior controls through infrequent periodic review. Disapproval, nonsupport, or veto of personnel manager's decisions very unusual and infrequent.

AREA OF AUTHORITY USE BY PERSONNEL MANAGERS

very unusual and infrequent.

approving the final plan. At the far right of the figure the personnel manager has nearly complete freedom to plan, approve the plans, and implement them without reference to his superior.

A Continuum

Obviously, where one operates on this continuum will depend not only upon the importance of the decisions involved, but also upon forces in both the president (e.g., his desire to develop his subordinates) and the personnel manager (e.g., his imagination, initiative, and willingness to take on responsibility.)

Most authors would have us believe that the personnel manager falls to the left side of the figure. We submit, however, that personnel managers find the subcomponents of their functions distributed over the entire continuum.

The Velvet Glove Plus

As we have indicated, in his daily actions the personnel manager may sound more like an advisor than a functional executive. He may depend upon persuasion and expertness much more than on his ability to "order" that any action be taken. Indeed, in the long run his success depends very much upon his expertness and persuasiveness. But the production manager and the sales manager also are much more dependent upon persuasion than upon the exercise of bald discipline. This is true of all executives.

In conclusion, we find the use of the word "staff" in referring to the personnel director to be symptomatic

of popular misconceptions about his role. This word implies that the personnel director is solely advisory—that he accomplishes all his work by virtue of persuasion and expertness. This does not square with reality, with real personnel directors and real business organizations as we have observed them.

Conclusions

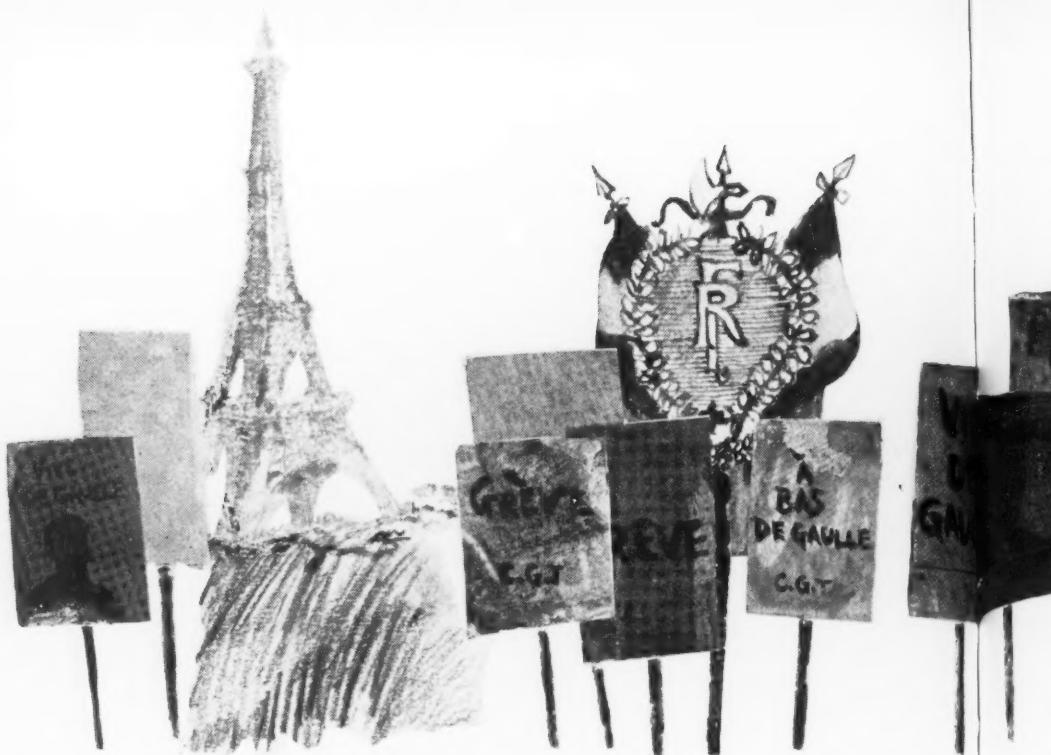
We find it useful to analyze the personnel director's role in terms of the authority he exercises, in contrast to the influence he exerts; to compare his authority in planning with the authority he exercises in the implementation of plans, and in the kind of authority he possesses in contrast to that possessed by executives in non-functional organizational units.

Also, we find it useful to break down the major components of the personnel manager's job for purposes of analysis. A study of these subcomponents indicates that the authority he exercises varies considerably between and within the various components of a given personnel activity. To focus solely on the major components without subdividing them obscures the real nature of the role.

In summary, we think that the authoritative aspects of the personnel manager's position are as much in evidence as are the influential aspects of that position. We think it would be highly useful to relegate the mythical personnel manager to the realm of folklore and to focus greater attention on the real authorities vested in real-life personnel managers in the modern corporation.

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LABOR RELATIONS IN FRANCE

FREDERIC MEYERS

Never underrate the power of French unions. Don't be fooled by their apparently scant formal membership, tenuous financing, and violent ideological disagreements, this article based on recent firsthand observations advises. The truth is that unions in France represent and have the support of a large segment of the working force for, under French law, certain key union contracts set industry-wide labor standards to which all employers must adhere.

During the past year Professor Meyers has been working abroad as a Fellow of the Guggenheim Foundation, studying various aspects of French and British labor relations. Readers of the California Management Review will recall that in our last issue he discussed British labor law and union-management relations. Here, he analyzes French labor law and unions. Taken together, the two articles point up many contrasts between French, British and American ways of meeting the same problems. Dr. Meyers, by training an economist and also a Member of the Bar in Georgia, is Professor of Personnel Management and Industrial Relations at the University of California, Los Angeles, a frequent arbitrator of industrial disputes, and the author of many monographs on labor.



Labor relations in France are extremely complex. As a result, the American businessman, interested by France's important role in the Common Market, by her great industrial diversity and experience, by her skilled labor force and her large internal market, who seeks to set up shop there often finds himself baffled and bewildered by the labor relations problems he may encounter.

In virtually no free country in the world is there more minute legal regulation of collective bargaining. For example, in France collective contracts are looked upon as virtually state-sanctioned and have much the same force as statute law.

Conflicting Union Philosophies

The businessman operating in France must deal not only with a tangled maze of legal regulation—though perhaps not much worse than

the Taft-Hartley, Landrum-Griffin wilderness in the U.S.—but with a labor movement whose structure, objectives, and philosophies are not only unfamiliar but produce a kind of conflict within the labor movement that conditions all labor-management relations. And, though the labor movement appears to be weak in numbers, the businessman cannot afford to ignore it, not only because of the legal problems involved, but because its social and political influence are much greater than its apparent membership would seem to warrant.

It is the design of this paper to describe first the basic structure of French law which underlies labor relations and then to present some of the characteristics of contemporary bargaining institutions, unions and employer groups, in the hope that this will be of some aid to those interested in investment problems of businessmen in France.

The Background of Labor Law

Like England and the United States, France began its development of a national labor policy by suppressing all combinations founded on alleged common industrial or trade interest. The first law on the subject after the Revolution, the *Loi Le Chapelier* of 1791, forbade combinations of workers. It parallels British

and American common and statute law of conspiracy of the period.

All three expressed the liberalist view that the public good is best served by requiring individuals to pursue their own self-interest individually. But from these common beginnings over the next century and a half wide divergences developed.

While the British turned to the "collective laissez-faire" described in an earlier article,¹ France like the United States has enacted minute rules of law governing labor-management relations. But the French and American philosophies and purposes of regulation differ widely. France recognizes intergroup arrangements as quasi-public in character, so that employers and unions develop rules, within legal boundaries, which may become a charter for an entire industry, or in some cases for the entire economy, binding upon other employers and workers not parties to the agreement.

The development was slow. The Code Napoleon dealt as harshly with unions as Revolutionary law. It was not until 1864 that any right to strike was recognized, and not until 1884 that unions, as permanent institutions, were endowed with the legal right to exist.

Partly because of certain remaining legal obstacles, but more importantly because of the primacy of revolutionary aims in the French labor movement, collective bargaining did not develop as a significant institution in France until after World War I.

Collective Bargaining Begins

Under a law enacted in 1919, there was a brief but rapidly receding wave of negotiation of collective agreements; 1936 and 1946 also saw sudden spurts in bargaining activity fol-

lowing favorable political and legislative developments. However, it was not until 1950, again following the enactment of new and favorable legislation, now the basic law of union-management relations, that collective bargaining developed into a significant and seemingly lasting institution with pervasive influence on the French economy and on French industrial relations practice.

Even now, the institution of collective bargaining is still in the developmental stage. Experience under the 1950 law is limited and coverage is far from complete. As of November, 1958, slightly under 200 national agreements, including special supplements covering particular categories of workers, were in effect.

Of these, only 42 had been extended by the Minister of Labor to cover an entire industry or branch of activity as provided by the law. There were also about 450 ordinary agreements, regional or local in nature, and nearly 4,000 plant agreements which either supplemented master contracts or were independent agreements limited as provided by law to wage matters.²

Shop Stewards

The legal framework within which French employers deal with representatives of their employees³ provides for three levels of employee representation—shop stewards, elected works and firm committees, and union officials—in the negotiation of collective contracts. The form and often the content of these dealings is delimited by law.

Under postwar legislation, shop stewards must be chosen in government conducted elections in all plants which employ ten or more persons,

whether or not the employer "recognizes" a union or is party to a collective agreement.

Candidates for election may be presented by affiliates of each of the three major French trade union federations and by one or more of the several independent groupings of unions, so long as they have been declared eligible by the Minister of Labor in accordance with statutory criteria. Separate stewards are elected for manual workers, white collar, technical and professional, and supervisory employees.

In an establishment of any size, stewards will usually be elected from candidates proposed by two, or all three, of the large rival groups, as well as from those presented for white collar workers by the Confédération Générale des Cadres (C.G.C.), the major independent grouping of unions seeking to organize white collar and supervisory personnel.

Shop stewards represent workers in a plant in processing both individual and general grievances, though the former is probably the more important of their functions. Internally elected union officials take major responsibility for general grievances and claims.

Individual grievances may arise out of the whole context of employer obligations which directly or by inference give content to the individual's contract of employment: the contract itself, relevant clauses of collective agreements, if any, written work rules which are required by law, custom, and the many statutes which require specific conditions of employment such as vacations, minimum wages, hours of work, dismissal notice, and other such matters. It is the primary duty of shop stewards to represent

employees in disputes arising out of this whole complex of rights and obligations.

Secondly, the French employer deals with representatives of his employees elected to serve on works or firm committees. Such committees are required to be established in all plants of fifty or more employees. Members of works committees are elected from lists proposed by the several union groups.

At least two "colleges" or groups of representatives, are required by the law, one for engineers and supervisors, and one for all others, though by agreement with the unions, further subdivisions may be, and often are, made. The chief executive of the plant serves *ex officio* as president. In multi-plant firms a central firm committee is chosen by the several plant committees.

Works Committees

Works committees are charged by law with the management of welfare activities of the firm, such as welfare or assistance funds (other than social insurance funds governed by formal mutual organizations), canteens, crèches and other such ventures.

In addition they are given a wide range of consultative functions. The employer is required to keep the committee informed from time to time about the affairs of the business including such matters as productivity, costs, prices, profits and other relevant matters. It receives all documents provided to stockholders and may make any comment it sees fit. It is entitled to the assistance of an accountant appointed from a list approved by the Minister of Labor and paid for by the firm.

French law provides tax advantages

for collectively bargained productivity premiums and for stock participation schemes negotiated under specified conditions. The works committee must be consulted in the preparation of these schemes and represents workers in their administration.

Committees must be provided copies of draft work rules and may comment on them to the Government Inspector of Labor who must approve them for legality. In large plants, there must be a standing health and safety subcommittee of the works committee. There are a variety of other specific and general consultative functions provided for in the law.

It is a criminal offense for an employer or anyone else to interfere with the performance of the functions of the works committee or shop stewards. In addition, members of the committee, shop stewards, or candidates for these offices may not be dismissed during their candidature, their tenure, and six months after the expiration of their office, without the assent of the works committee or, failing that, permission of the Labor Inspector.

A last recourse is appeal to the courts for judicial dissolution of the contract of employment. They may be suspended until decision of the Inspector, but if this is adverse to the employer, the suspended stewards or committeemen must be restored to the performance of their functions and their pay resumed.

Types of Collective Contracts

The third level at which the French employer deals with representatives of his employees is in the negotiation of collective agreements. Historically, after the decision was made to permit and then to foster collective bargain-

ing, French public policy envisaged the development of collective agreements which would become a kind of law for whole segments of the economy. Some retreat has been made from this policy, beginning in 1950, but it still represents the major direction.

Accordingly, of the three types of agreements for which French law makes provision, that toward which the others are intended to develop is the "Agreement Susceptible to Extension." By extension is meant the compulsory application of the terms of the agreement by decree of the Minister of Labor to a whole industry or branch of activity, nationally or regionally. Such agreements must be negotiated in *Commissions Mixtes* convoked by the Minister of Labor and consisting of representatives of the appropriate groupings or associations of employers and the "most representative" unions.

"Most Representative" Union

The connotation of the right of representation differs radically in France from that in the United States. It is not intended to give a single union exclusive rights in a bargaining unit as is the case here. To the contrary, in most bargaining situations more than one union is "most representative." The standards to determine which unions are most representative are statutory and are applied administratively, subject to judicial control, for abuse of power. They do not include elections. Normally they are applied throughout an industry nationally or regionally or in a branch of economic activity, rather than separately for a particular plant or firm.

It has been administratively determined that generally all affiliates of

the three major trade union confederations and the C.G.C. are most representative within their jurisdictions, and certain other unions have been so declared on more limited bases.

It is quite possible in France that, for purposes of bargaining at plant or sometimes broader levels, a union may be considered most representative even though it may have far fewer members than other unions which also are most representative. Indeed it may have little or no membership.

The employer or employer association bargains with all of the several most representative unions, and each is qualified to enter into a collective agreement. Only one agreement, of course, is signed, to which one or more unions affix their signatures. Not all such unions must sign, though those which refrain from signing may subsequently adhere.

Scope of Primary Facts

The geographical scope of Agreements Susceptible to Extension may be national, regional or local. They are intended to be multiemployer in coverage. They must provide appropriate terms of employment not only for manual workers but for all categories including white collar, technical and supervisory, though each such group may be covered in a separate supplement to which their separate most representative unions may be parties.

Such an agreement applies only to its parties until it is extended by the Minister of Labor to apply to a whole industry or branch of activity. However, a nonsigning union is not legally responsible for such of its acts as may be contrary to the provisions of the agreement.

In Agreements Susceptible to Extension, certain topics must be dealt

with, and there are others which are optional. The prescribed topics include:

- Protection against discrimination for union membership or because of political or other opinion
- Various aspects of wages and wage payment
- Hiring and layoff procedures
- Apprenticeship, training and special provisions for working conditions of women and young workers. Wage provisions must include implementation of the principle of equal pay for equal work of women
- Procedures for the election and functioning of shop stewards and works committees
- Procedures for conciliation and for revision or termination of the agreement.

Optional subjects cover such matters as shift and night work, various kinds of premiums, pensions, and arbitration provisions to cover general but not individual grievances and disputes. By special statute closed or union shops or checkoff provisions are unlawful.

Minimum standards for many of these subjects are prescribed by statute, and collective agreements often do little more than incorporate these by reference. Agreements may offer employees more favorable conditions than the minimum requirements of the law, but may not offer less.

Ordinary Agreements

A second class of permissible collective agreements is the "Ordinary Agreement," also normally multiemployer and national, regional or local in scope. Such contracts are nego-

tiated without the intervention of the Minister of Labor directly between groups of employers and properly constituted unions, though the unions need not be the most representative.

They cover employees of employers signing the agreements and members of any signatory employer associations. The law requires that Ordinary Agreements must include procedures for conciliation and for revision or termination. This is the only required content.⁴

Plant Agreements

The third type of agreement that may be negotiated is the plant agreement, which consists of two types. If it is between an employer and one or more unions who are also parties to a multiemployer contract, it may expand and supplement the master agreement in any way considered appropriate by the parties. On the other hand, consistent with the policy of furthering the negotiation of agreements which will provide a system of rules for an entire segment of the economy, a plant agreement between unions and an employer not covered by a broader contract is limited by law to wage matters only. Unions party to either type of plant agreement must be the "most representative."

Labor Courts

Individual grievances that may arise under collective agreements or individual contracts of employment are handled at plant level by shop stewards, sometimes assisted by union officials. Those involving individual contractual rights which cannot be settled by direct negotiation become subject to the jurisdiction of the special labor courts, the *Conseils de Prud'hommes*.

They may also be voluntarily sub-

mitted to the grievance or conciliation procedures provided for in collective agreements but rarely are, since these are better adapted to general disputes between unions and management. Further, it is illegal to deprive labor courts of jurisdiction in such matters, and arbitration of purely individual grievances is completely unknown.⁵ The only common contractual procedures dealing with individual disputes are provisions that before final action is taken in discipline cases the worker, assisted by his shop steward, must be heard.

Labor courts are composed of equal numbers of elected representatives of workers and of employers from within the geographical jurisdiction of the court, assisted by a Secretary. The magistrate of the local court of original jurisdiction has a casting vote in case of a tie. These courts have power to decide all cases arising out of individual contracts of employment, including, but not limited to, claims which come from rights and obligations conferred upon the individual by reason of the existence of a collective agreement.

Thus, most individual grievances—which in the U. S. might be subject to possible arbitration or go to the ordinary courts—in France go first to the labor courts. Appeals on matters of law, however, go through the ordinary civil courts.

In contrast, there is in France very little in the way of legal procedures for the settlement of general disputes between unions and management either over interpretation of existing agreements or over changes or renegotiation of contracts.

As indicated, master agreements must have a conciliation procedure, but the terms of that procedure are

determined by the parties. Typically they may include a bipartite national commission composed of representatives of unions and of employer associations to decide national questions of interpretation. Specific questions not settled at plant level go to a bipartite regional commission, and, on appeal, to a national commission.

Right to Strike Protected

No-strike clauses in collective agreements usually run either for a few days only, or until contractual conciliation procedure is exhausted. The right to strike is constitutionally protected in France, and statute law declares that participation in a lawful strike only suspends but does not breach the contract of employment, except in the case of serious offense by the striker. The significance of this is that an employer cannot legally dismiss a striker except for specific and individual misconduct such as violence, threats or sabotage during the course of a strike.⁹

French courts have held that the constitutionally protected right to strike refers only to strikes over industrial matters and does not protect political strikes which have, historically, not been uncommon in France.

Furthermore, the courts have held that certain kinds of direct action engaged in from time to time by French workers, such as sit-downs, slowdowns, or sabotage are not protected as part of the right to strike. Thus employers may dismiss workers engaging in such actions even in pursuit of an industrial objective. Workers may also be required to observe contractual strike notice provisions and a union may be sued for damages if it can be proved that it is responsible for a political strike, or for the types of direct action, mentioned above, which have

been outlawed by the courts. But the technical requisites for such a suit can almost never be established.⁷

There is nothing in French law to prevent organized workers from striking at any time over claims for changes in agreements, or from demanding better terms from individual employers than those provided in master contracts and from enforcing such demands by strikes, provided the strike is peaceful and conducted in a proper and lawful manner. In fact, French employers do face the continual possibility of a partial or complete work stoppage.

Ideology of French Unions

The structure of the French labor movement is radically different from that of the American or British.⁸ Perhaps its most significant characteristic is its ideological pluralism.

The three major competing confederations of unions represent three different views of the role of the trade union in society. (A "confederation" is a trade union center roughly analogous to AFL-CIO, composed of affiliated unions.)

The largest, the Confédération Générale du Travail (C.G.T.) is, at least constitutionally the oldest, dating back to the turn of the nineteenth century. When C.G.T. was captured by the Communists after World War II, the Confédération Générale du Travail-Force Ouvrière (C.G.T.-F.O.) was formed by groups splitting off from C.G.T.

The third major confederation, the Confédération Française des Travailleurs Chrétiens (C.F.T.C.) has had a continuous history since 1919.

The common element in the ideologies of the three confederations is their unwillingness to accept the basic insti-

tutions of capitalism, and their devotion to trade unionism as an instrument of social change. Though each is constitutionally committed to independence of political parties, each has a dominant ideological current.

The C.G.T. is dominated by the French Communist Party. C.G.T.-F.O. consists largely of elements representing the old anarcho-syndicalist tradition and more modern noncommunist socialists. The C.F.T.C. in its original concept was inspired by the social principles of Catholicism, though it now asserts its independence from the Church, and welcomes members of any creed. Its ideological aims are directed toward a partnership of workers and owners in the management of enterprise.

In addition to these three major groups, there is C.G.C., the politically neutral federation of technical, professional and supervisory unions. Also, certain small autonomous and independent groups of varying political hues exist.

Weakness of Unions— Scant Membership

The second outstanding characteristic of the French labor movement is its weakness in membership. No one knows with any precision the total membership of French unions—indeed it is difficult even to define membership. Dues payments, though rates of dues are very low, are irregular even among workers considering themselves union members and considered by their organizations as such.

Consensus among informed observers interviewed is that union membership certainly does not exceed 25 percent of the total French labor force. While all agreed that government employees are highly organized, they

added that only a relatively small percent of privately employed French workers pay union dues with any degree of regularity. Some estimates of the proportion of union members in the private sector range as low as 10 percent.

The significance of this weakness in membership can be exaggerated, however. There is little of the active hostility to unions that sometimes appears among certain U.S. employees. Rather, even the nonmember generally regards the unions, or one among them, as his legitimate spokesman in industrial and legislative matters. In bargaining over economic issues, unions can count on support much greater than is measured by their membership, though that support is often uncertain, undisciplined, and does not extend to providing the necessary financing.

Politically Powerful

Furthermore, at the legislative level, the noncommunist unions are officially regarded as the proper spokesman for employee interests. Despite apparent weakness, unions have succeeded in getting into law a wide variety of social legislation of considerable import. Beyond this, they have served as a major bulwark of support for continued democracy in the face of threats from extremists, most recently over the Algerian problem.

Of the three major confederations, C.G.T. is far the largest and strongest, at least among industrial workers. When workers cast their ballots for candidates to office as shop stewards or members of works committees presented by the rival groups, C.G.T. polls generally half the vote, or more, with C.G.T.-F.O. and C.F.T.C. sharing the balance. While nonunionists as

well as union members vote in these elections, real membership is probably not far from these proportions. C.F.T.C. is probably stronger than C.G.T.-F.O. at least in private industry. Dues discipline is possibly the best of the three in C.F.T.C.

Estimate of Communist Influence

The relatively large membership of the C.G.T. does not mean that the dominant political philosophy among French workers is Communism. First, as we have already remarked, only a small minority of workers belong to any union. Second, many noncommunist groups did not follow those who led the split and formed F.O. since trade union unity was a historic article of faith in C.G.T., and many had represented a schism of a Communist-led minority in the inter-War years. These groups felt that the struggle against Communist domination should be carried on within the C.G.T. Thirdly, the Communists, by retaining control of C.G.T. and forcing the noncommunists to secede, retained much of the symbolism of the name and tradition of the old confederation.

Finally, C.G.T. with its often irresponsible militancy has been able to capitalize on the fundamental hostility of many segments of the French working class to the institutions of capitalism and on their sense of exploitation. C.G.T.-led strikes for economic goals succeed in getting much better support than their outright political strikes. Indeed it is now doubtful that C.G.T. could get substantial following for a political strike except in a very few plants or localities.

Affiliated with the confederations are federations of unions, generally by industry, though there are special federations of white collar workers, engi-

neers, and other technical and professional workers. These are roughly analogous to the American national unions. However, their internal constitutional structure leaves to the subordinate *syndicats*, that is, local or regional unions, much greater autonomy than is the case in the U. S. *Syndicats* of the several federations affiliated with each of the confederations are organized into regional bodies by "department" roughly similar to the state federation in the U. S.

Representation in *Commissions Mixtes* convened by the Minister of Labor for the negotiation of national Agreements Susceptible to Extension, or in bargaining groups negotiating ordinary national agreements, is provided by the federation. For regional or local agreements, the *syndicat* is the formal negotiating body, though it may be assisted by officers of the federation.

Undermanned and Poorly Financed

By any standards, French unions are generally seriously undermanned with full time paid officers and staff. This, of course, is due largely to underfinancing. C.G.T.-F.O. and its affiliated unions clearly suffer worst. Many of its federations in major industries have fewer than half a dozen full time officers. C.F.T.C. appears to be considerably better financed, partly because dues payment is more regular, but partly also because of a centralization of certain functions and of dues collection in the confederation.

Unlike the other two confederations, in which dues are collected by the *syndicat* and passed upward, in C.F.T.C., dues are forwarded to the confederation and passed downward. The confederation, thus is able to assure itself its proper share of what dues are col-

lected and uses them to provide reasonably adequate staff service to its affiliates.

C.G.T. is better financed than F.O. if for no other reason than its very much larger membership. There are allegations also of financial support from the French Communist Party, but the truth of these is uncertain. For all unions, however, the American businessman will find union officials very poorly backed up by legal, research and other staff services.

Competition Between Unions

The two most important characteristics of the French labor movement—ideological pluralism and weakness both in members and financing—condition its relations with employers. There is most strenuous competition to attract the vast majority of uncommitted and often apathetic workers.

Unity in the labor movement is a slogan both within C.G.T. and C.G.T.-F.O. Yet the Communists are only willing to accept unity on terms of continued Communist domination, the condition which led to the split and which F.O. cannot and will not accept.

C.F.T.C. has always believed in pluralism and the separate maintenance of a labor movement based on its special philosophy. Despite recurrent reports of a rapprochement between F.O. and C.F.T.C., the three way division of the French labor movement seems likely to continue into the indefinite future.

The pace of competition between the three groups is usually set by the C.G.T., whose ideological position permits it to sustain the most extravagant and irresponsible bargaining positions, and to play on the deep-seated sense of hostility to their employers of many French workers. Intermingled

with bargaining slogans are usually the political ones, so that bargaining strategy is often used by C.G.T. in an effort to show support by French workers of the political programs of the Communist Party.

It would appear that cooperation between C.G.T. and C.F.T.C. would be most unlikely, since the philosophy of the latter is the worst kind of "class collaboration" in the eyes of the former. For an immediate example, whereas C.G.T. regards the works committees as instruments in the class struggle to be used only as such, C.F.T.C. regards them as a first and constructive step toward full partnership. Yet C.F.T.C., confident of its established though minority position, often finds it tactically advisable to cooperate on the basis of limited immediate demands at the local level with C.G.T.

C.F.T.C. has often been willing to accept competition on the basis of bargaining militancy, striving for a share of the prestige that comes with economic gains achieved through struggle. Its tactics have been those of settling for the attainable, hoping to gain credit, and leaving C.G.T. in the position of holding out for the unattainable and achieving nothing. This tactic, however, entails the risk of charges of softness or sellout, and C.F.T.C. has had to play this game most carefully. C.G.T. has often refrained from signing agreements, pointing out their weaknesses sometimes years later.⁹

F.O., at least in private industry, has been in a most difficult position. Its lack of strength has made it most difficult for F.O. to lead the bargaining struggle. While most of its leaders are convinced revolutionaries of several noncommunist varieties, circumstances have forced some of them into

an almost American pragmatism in day-to-day demands. But without the strength that makes a union work, pragmatism is called responsibility and responsibility sometimes degenerates into dependence upon employers, some of whom really wish to strengthen noncommunist unions while others play the game of interunion competition only for short term gain. Other F.O. leaders have remained closer to the traditional suspicion of any real bargaining.

Tactics

A narrow field of tactical maneuver and lack of finances have made it difficult for F.O. to repair its weaknesses. Indeed, in terms of membership and votes for shop stewards and works committee members in private industry it has probably been losing slowly, while C.F.T.C. has been gaining and C.G.T. has been recovering its losses incurred after the Soviet intervention in Hungary. Despite this, F.O. often speaks effectively and even occasionally leads in certain bargaining situations and in legislative negotiations.

It should be noted that union organization extends much farther upward in the hierarchy of employees in France than it does in the U. S. Lower level white collar workers, called *employés*, to distinguish them from manual workers or *ouvriers*, are eligible and often belong to unions. But furthermore, supervision at all but the highest levels, professional employees and technicians also may belong to unions, elect shop stewards and members of works committees and bargain collectively. In fact, as we have noted, collective agreements susceptible to extension must have sections covering all these categories.

Often workers other than manual

workers will belong to the same unions as will the manual workers, though the union may have separate administrative machinery to handle their problems. In addition, national unions whose membership consists exclusively of nonmanual workers exist. In some cases, the white collar workers, technicians or supervisors will have, in effect, double union membership through the affiliation of a local *syndicat* both to an industrial and a white collar union.

The Confédération Générale des Cadres competes with affiliates of the three major confederations for professionals, technicians and supervisors. It is politically independent, and concerns itself more devotedly with job problems than do the other groups. It represents substantial numbers of employees and is signatory to the major national collective agreements.

Employer Collective Bargaining

As we have previously noted, all collective agreements except certain plant agreements limited to wage matters or supplementary to broader agreements, are multiemployer in character. They are negotiated between the several unions and properly constituted associations of employers. French business is highly organized for purposes of dealing with labor relations matters.¹⁰

At the top of the hierarchy is the Conseil National du Patronat Français (C.N.P.F.), a national association covering all of French industry. It has special sections dealing with matters of labor relations and social legislation. These provide staff advisory services of various kinds to industry associations and affiliated members.

On rare occasions C.N.P.F. has dealt directly with trade unions on matters

of general policy. Recently, in December, 1958, C.N.P.F. reached a true bargaining agreement with the major union confederations creating a system of supplements to state unemployment assistance, financed by employee and employer contributions. Extended by the Ministry of Labor, it now covers virtually all employers in industry and commerce, and is administered by bipartite boards at national and regional levels.

In each industry, a national employer association represents and provides service to affiliated employers. In those industries in which national collective agreements exist, they were negotiated in behalf of employers by the national association.

Industry-Wide Pacts

All individual employer members in the relevant industrial category automatically become parties by reason of their membership in the association. Nonmember employers, of course, are not bound, unless the agreement has been extended, but until they become party to a regional or national agreement, they may negotiate only wage agreements covering their plants.

Regional and local chapters of the national industry associations negotiate regional or local agreements, or regional or local supplements to national agreements. These in turn bind all members of the association, though special exception of specific firms is occasionally made in certain agreements. In the conduct of their regional or local negotiations, regional or local associations may be assisted by experts from the national association. Often such associations are bound by or adhere to bargaining policies set by the national association.¹¹

For most firms, formal bargaining

with unions is done through membership in an employers' association. However, some firms not parties to national agreements have worked out wage agreements at plant or firm level. Some few notable firm agreements supplementing national or regional agreements have also been negotiated. These are worked out on *ad hoc* bases with the unions at local levels.

As indicated above, day-to-day administration of collective agreements is carried on for the employees by the elected shop stewards, and grievances may also be dealt with by the works committees. Complex grievance procedures at plant or firm level are rare in French industry, though for general grievances "conciliation" procedures going up through the hierarchy of employer associations is common. These procedures have been described earlier in this article.

The Climate of Labor Relations

By the measure of time lost because of strikes, French labor relations appear at least superficially to be good. Since strike statistics are collected on somewhat different bases in the U. S. and in France, they are a little difficult to compare. However, according to a comparison made by the International Labor Office, in only three of the eight years beginning with 1947, did days lost per thousand workers in transport, manufacturing, mining and construction in France exceed those in the U. S. Two of those three years were 1947 and 1948, the years of the great political strikes in France.¹² For the seven years ending in 1958, the number of days lost per worker because of strikes in the U. S. was about three times that in France.¹³

These general figures are, however, somewhat deceptive. Though they re-

sult in relatively little total time lost, French strikes are frequent and pervasive, though short. In 1959 a little more than one out of every twenty French workers¹⁴ was individually involved in a strike. Some of them participated in several strikes.

Except for one prolonged large strike, 1959 was a year in which strikes were relatively infrequent. Since only about one of every three workers in struck establishments did in fact strike, something like one out of every five French workers worked in a plant in which at least one strike took place in 1959.

Because the employment figures include small establishments in trade and commerce, the incidence of strikes is even higher in large industrial enterprises. The average duration of strikes in 1959, the lowest since the War, was only one day, and about fifteen percent lasted an hour or less.¹⁵

These data show a strikingly different pattern than in the U. S., and are explained by the different tactics of French unions, tactics shaped in large measure by their weakness.

Relatively few French strikes are begun with the intention of reaching a settlement before a return to work. Usually they are short demonstrations of an hour or so. Sometimes a whole series of such short demonstrations will affect a plant over a relatively short period of time. The low rate of strike participation is in part a result of the refusal of workers to obey a strike call and in part due to the fact that workers belonging to one union will not always participate in a strike called by another.

It is also due to the tactic of striking only one section or department, or calling strikes in several departments one after another. Demonstrations of

dissatisfaction include not only the outright strike, but slowdowns, adhering strictly to plant rules, producing deliberately faulty workmanship and a host of other similar tactics.

Most French strikes are over wage issues, but a variety of other kinds of problems are at least the nominal causes of conflict. Whatever their causes, strikes can take place at virtually any time. National and regional collective agreements are simply minimum standards, and contain nothing to prevent a union from seeking better terms at any time from the individual employer. Issues of interpretation or application of agreements, other than those involving purely individual disputes which may go to the labor courts, have no definitive methods of settlement.

Continuous Tension

After contractual conciliation or strike notice provisions have been complied with, strikes during the term of an agreement are perfectly lawful. The French employer can rarely look forward to an extended period of assured uninterrupted production. A strike, though ordinarily of very short duration is always a possibility. With some notable exceptions, relations between French employers and unions of their employees are in a continuous state of tension.

There are many and reciprocal reasons for this. At the outset it should be emphasized that, though the French labor movement is relatively old, few French unions or employers have had any lengthy or continuous experience in collective bargaining.

There was a short flurry of collective agreements after the first World War. From 1936 to 1939 there was again a sudden increase in the num-

ber of agreements, after organized employers and the unions, under the sponsorship of the Popular Front Government, agreed in the "Matignon Agreement" of June 7, 1936, to the principle of collective bargaining. The law of June 24, 1936, implemented the agreement.

But the War and Occupation put an end to this period. Despite understandings reached between employer and union groups in the Resistance, the Constitution and Law of 1946 failed to stimulate the practice of bargaining as greatly as had been hoped. Since 1950 there has been a slow growth, but the attitudes of both unions and employers are still quite tentative.

Even such experience as there has been has not been of such a nature as to stimulate effective day-to-day relationships between individual employers and local unions. The basic French concept of the role of the collective agreement has not been the American one in which it forms a framework for effective relations at plant level, but rather it is looked upon in France as a means of regulating an entire industry.

Pacts Often Become Law

The agreement is regarded as minimum law, ideally uniform throughout an entire industrial sector. Often it has been a mere prelude to the enactment of social legislation, as on vacations or periods of notice. In France, provisions of collective agreements become patterns for and are superseded by legislation. Until the law of 1950, the French looked with suspicion on plant agreements. In many respects they still do. Even now, the content of plant agreements is severely limited unless the employer is party to an industry contract.

Employers do, of course, deal from day to day with elected shop stewards and works committees, but often with the greatest reserve. There is a considerable difference, furthermore, between even a sincere effort to solve immediate problems with representatives of one's own particular employees, and reaching a viable and effective bargaining arrangement with a union as a continuing institution. It is this latter relationship which is rare in France.

Inexperience is aggravated by mutually reinforcing attitudes which may account for past failures and which make future successes difficult.

On the union side, the old anarchist tradition positively rejected continuing collective bargaining. French unions, unlike the American whose real reason for being was to bargain, grew with a philosophy which saw as their function preparation for the general strike after which workers through their local unions would assume control and management. In the interim, while specific demands might be sought by local strikes, bargaining which recognized even a temporary accommodation with owners was outside the tradition.

Union Aims Are Revolutionary

This old stream in the tradition of the French labor movement has been diluted, even almost submerged by other philosophies. F.O. and C.F.T.C. unions are generally ready to accept contemporary institutions at least to the degree necessary to achieve a really constructive bargaining relationship, though neither has abandoned its revolutionary aims.

In the left of F.O. there are still groups whose hostility to the institutions of capitalism and to owners and

managers is such that they must be most difficult to deal with. As for the main stream of F.O., however, it, like the socialist unions of Britain, does not permit its ultimate goal to interfere with reasonable solutions to current problems.

What does interfere, however, is the continued presence of Communist-dominated unions with whom the non-communist must compete. While C.G.T. talks at times about collective bargaining, its major and immediate aims are not to make bargaining work. When it may bargain in apparent good faith, it does so only as a means to other ends. The hands of minority groups are often tied by the necessity to stay alive in the face of C.G.T. irresponsibility.

How C.G.T. Holds Power

One may wonder why and how C.G.T. is able to maintain its majority position. At the outset, it should be noted that so far as union membership is concerned, over the past fifteen years, it has been a majority of an ever smaller total. Real dues-paying union membership among all French workers may be today not much more than one-fifth that of 1946.¹⁸ Furthermore, C.G.T. is increasingly less able to lead French workers into political strikes and demonstrations.

But when French manual workers are required to express a preference by voting for candidates to represent them as shop stewards, works committee members, or representatives on the various bodies administering social security schemes, they consistently choose a majority of C.G.T. candidates. This has been true ever since the 1948 split in the labor movement. Events of 1956 in Hungary only temporarily reduced C.G.T. majorities;

by now those losses have been regained.¹⁷

We have already categorized some of the reasons for this allegiance to C.G.T., however apathetic it may be. A not insignificant reason is a latent hostility by workers to employers as a group, an attitude, which, unfortunately, some French employers have done little to mitigate.

Employer Paternalism

French employers have traditionally guarded their authority most zealously. On the one hand, many of even the largest of French enterprises have been family businesses, in which the owner has insisted on being master, a kind of *pater familias* with a paternal authority even greater than that in the natural family.

Often this paternalism has been most humane and materially generous, but without any surrender of authority. Such employers have often been slow to accept the necessity of dealing with employees and their unions as equals, and this resistance has been a factor in accentuating the antiemployer attitudes of workers.

Certain other French employers have a kind of philosophy of technocratic aristocracy. Knowing their own undoubted competence in industrial and managerial matters, they see no reason to consult their employees about anything, even matters which vitally affect the workers' interests. They bitterly resent anything which appears to question their ability to make all decisions. Such employers are unable to come to terms with unions except on a basis of force and mutual resentment.

Optimistic Outlook

Despite these cumulative and mutually reinforcing attitudes, somehow

one has the feeling that a corner has been turned in French labor relations. The objective evidence is scanty. It lies in the slow growth in the numbers of collective agreements at all levels, in the increasing unwillingness of workers to follow C.G.T. despite their votes, except where there is a real economic issue, and in the reduced incidence of strikes.

More, successful bargaining has been achieved in the face of a weak and divided labor movement. It testifies to the presence and increasing influence among French employers of groups who have come to recognize, first, the necessity for an escape from mutual hostility and second, the mutuality of responsibility for it. Their path is difficult, and has not yet, except in a few individual cases, been put to the test of serious economic problems or underemployment.¹⁸ It

must be most frustrating to be faced with C.G.T. irresponsibility and the frequent ineptitude of others with better intentions.

Nevertheless one has a strong sense of a "social climate" in French industry better than that of any postwar period since the exhilaration immediately following the Liberation. French industry has responded remarkably well to the technological challenge of broadened competition. It may be well on the way to an effective response to the human challenge of labor relations in a democratic society. It may seem difficult both for responsible unions and employers to recognize that the prerequisite is mutual acceptance, and mutual strengthening of constructive cooperation without demanding dependence. But this is what is required and this may be what is very slowly being produced.

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(The author gratefully acknowledges his indebtedness to the Guggenheim Foundation, the UCLA Business Research Associates, the UCLA Institute of Industrial Relations, and the Fund for the Republic which contributed to a year's European research into various aspects of industrial relations.)

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3. There is an enormous literature on French labor law. The two best general works are: Paul Durand and André Vitu, *Traité de Droit du Travail*, Vol. III (Paris, Dolloz, 1956), and A. Brun and H. Galland, *Droit du Travail* (Paris, Sirey, 1958), and its 1960 Supplement.
4. For analyses of the actual content of French collective agreements, see *Liaisons Sociales*, *op. cit.*, No. 2156; Germaine Lenoir, "Le Contenu des Conventions Collectives," *Droit Social* (Sept.-Oct. and Nov., 1955); Association Nationale des Directeurs et Chefs du Personnel, *Les Principaux Accords d'Enterprise*, Documents, A.N.D.C.P. (Dec., 1956).
5. It is probably also illegal. See Brun and Galland, *op. cit.*, pp. 156 and 965 and p. 17 of the 1960 Supplement.
6. While an employer cannot legally dismiss a striker for the act of striking, two general principles of French law provide, first, that the contract of employment can be

terminated (observing legal and contractual notice) at the will of either party, and, second, that an obligation to act or refrain from acting will be enforced only by damages. Further, an old doctrine provides that any right, including the right to terminate the contract of employment, may be exercised abusively. Thus, dismissal of a striker becomes an abusive exercise of a right, and the sanction is not reinstatement, but a damage award to the dismissed worker, measured by his actual loss incurred. In the usual dismissal case, the burden of proof of abusive dismissal, defined as dismissal either with malicious intent or culpable negligence falls on the claimant; in the case of a striker, this burden is reversed, and the employer must affirmatively show the commission of an offense justifying dismissal.

7. For a successful suit, see: Chambre Syndicale c. Union Maritime, Cour de Cassation, Chambre Civile, Section Sociale (8 January 1959). The basic legal difficulty in such suits is the proof that the union, rather than an *ad hoc* strike committee or the workers spontaneously, is really responsible for the strike.

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9. For example, C.G.T. first refused to sign the agreement with the Regie Renault providing for "Fonds de Regularisation," a fund destined to provide partial compensation for loss of earnings in the event of a reduction in hours of work. When, five years later, Renault laid off about 3,000 men, C.G.T. pointed out its suspicion of the efficacy of the old agreement to prevent layoffs. See various issues of *Le Peuple*, the C.G.T. biweekly, October and November, 1960.

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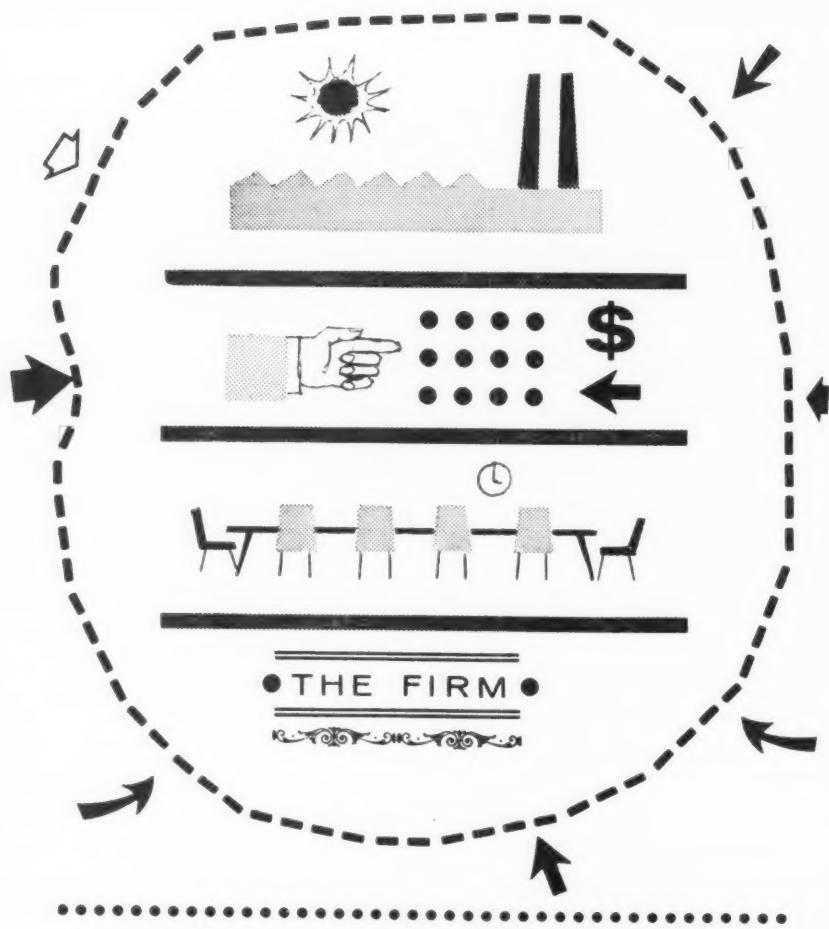
14. Excluding the public sector, agriculture and domestic service.

15. *Revue Française du Travail*, January-March, 1960, computed from this source.

16. Most or perhaps all of the loss was before 1950.

17. See: *Le Monde*, Paris, Sept. 13, 1960.

18. The Regie Renault, the nationally owned automobile plant, has often been cited as an example of the best in French labor relations. Yet in the fall of 1960, faced with reduced production primarily caused by losses in the U. S. market, layoffs were made in a manner reminiscent of older practice, and provoked great employee bitterness, including short strikes and even the sacking of an office.



THE CONCEPT OF THE FIRM

JOSEPH W. McGUIRE



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Sociologists, psychologists, economists, mathematicians, all view the firm in different lights. Some think of it as a blind organism, bent on survival at all costs. Others treat it as a rational being impelled solely by the desire to make a profit. Mathematicians chart its vagaries in terms of gaming theory and automationists look on it as a decision making machine. Sociologists analyze its group relationships and dynamics. All of which may prove, as this survey article indicates, that there is no universal definition for so complex a thing, and today's businessmen, seeking one, had best examine all such concepts with open eyes and an open mind.

EXECUTIVES generally have found it difficult to keep well-informed on all the latest developments in management science, decision theory, and operations research. Even more bewildering have been the changes that have occurred during recent decades in the disciplines underlying the area of business—in economics, mathematics, and the social sciences.

A wealth of material has become available which makes it clear to most executives that the theoretical foundations of managerial behavior are based securely upon a number of related disciplines. Despite this awareness, the relations between the behavioral sciences and actual management practices are often not fully understood.

For one thing, the sciences are not unified. Then too, each discipline has its own vocabulary which differs from that of the others, and all differ from terms typically employed in business.

Theories of managerial behavior—of decision-making as they have been termed—are based usually upon hypotheses originating in the social sciences. These theories represent the search for explanations and predictions of the behavior of the basic business unit—the firm. There is a good deal of ferment, however, on what exactly the concept of the firm should

be. An examination of this controversy, as we shall observe in this article, throws considerable light upon recent studies of behavioral scientists, mathematicians, economists and others as they pertain to business.

In this article we shall try to achieve three objectives: (1) To examine several of the more important concepts of the firm; (2) To reduce somewhat the confusion that results from the existence of a wide variety of notions of the firm by placing these ideas into two broad categories; and (3) To note that, while a profusion of concepts of the firm is probably necessary in the present state of business behavior, it is likely that some sort of eclectic concept, or some new "business" theory of the firm might eventually evolve as business becomes a more significant field for behavioral investigations.

Business Behavior Theory

If ever a general theory of business behavior is to evolve, it will be necessary also to derive a concept of the firm as a frame of reference for such behavior. (A frame of reference for a theoretical study is generally shaped by the problems to be solved and the goals to be attained.) Since the problems investigated and objectives sought vary widely among the be-

havioral sciences, it is evident that the frame of reference suitable to one might differ substantially from that employed in another.

For example, we could speculate that in attempting to derive a concept of the firm the economist might examine only its economic activities; the sociologist might be interested solely in group relationships; the psychologist might be concerned primarily with individual behavior; and the anthropologist might want to study the firm as a cultural institution. The concept of the firm that resulted would probably be different in each case, and each would reflect the frame of reference used.

Criteria for judging the merits of such concepts as the firm do not necessarily include their relation to reality, for obviously each concept is an abstraction of selected facets of business activities. In the medical sciences, to use an analogy, we may distinguish at least three levels of abstraction. The first of these is called *phenomenology*, which consists of the notation of physically observable facts or events. The doctor looking at a patient's tongue in order to diagnose his illness is an example.

A higher level of abstraction in medicine is *pathology*. Here the doctor might scrape away some tissue, and examine or test it to ascertain the nature of the patient's disease. In *biodynamics*, on the third level of abstraction, the doctor might examine under a microscope the active forces at work in the patient's cells.

In the study of the firm a start is generally made on the level of *phenomenology*, but the generalizations and concepts that emerge in theory are often so far removed from the day-to-day workings of any particular firm,

that they frequently reach the second or third levels of abstraction.

Normally, therefore, the concept of the firm in the behavioral sciences is highly abstract, and its usefulness is judged solely upon its merits as a theoretical container for problems to be examined and the assistance it renders in achieving solutions.

Two Basic Concepts

In order to establish a methodology for organizing the concepts of the firm in systematic fashion, we shall group them into two broad classes. The first will be termed *rationalistic concepts*, which are those that conceive of the firm as a unified acting entity or organism. The second will be called *behaviorist concepts*, under which the firm is generally thought to be the "confluence of several streams of interrelated behavior."¹

Behavioristic concepts generally presume individual behavior determined by environment, the actions of others, and personality factors. When the behavior of individuals in a microcosm such as the firm is determined, the behavior of the firm itself also becomes known. The rationalistic concepts, on the other hand, presume that the firm, or the group, has behavior patterns that may differ from the patterns of the components within it.²

Both broad categories are useful to the behavioral sciences. The behavioristic approach appears to be more logical and consistent, but since most of our data relates to firms or groups rather than to individuals, it is possible to talk rationalistically about firm behavior; so long as we realize that such behavior is the result of the combined patterns of individual behavior (unknown though these patterns may be) within the organism.³

Rationalistic Concepts

Rationalistic concepts of the firm are distinguished by at least four major characteristics. They are an emphasis on action by a collective rather than by actors in the collective, the common assumption of predetermined behavior patterns which are ordinarily presumed to be rational, a clear-cut goal, and an external environment which creates the need for action.

The rationalistic concept, which is somewhat similar to the mechanistic approach in philosophy and the stimulus-response concept in psychology, has been utilized traditionally in the economic theory of the firm. It is also employed with reference to the firm in the theory of games, statistical decision theory, and cybernetics.⁴ Some authorities would in addition include certain sociological and psychological theories in the rationalistic classification.

As Economists See It

The Economic Concept of the Firm. The traditional economic concept of the firm meets the four specifications of the rationalistic frame of reference. The concept of the firm in economic theory is centered around the actions of a coordinating unit, termed the entrepreneur, the behavior of which is conditioned by its drive to maximize its "incentive function."⁵

Customarily this incentive function is thought of as the greatest amount of profit that can be obtained within the parameters of the model.⁶ The parameters of action for the firm are prescribed by the predetermined assumption of rationality and by the competitive restraints established.

Rationality in economic theory implies that the entrepreneur will choose,

from among a relatively limited range of alternatives open to him that course of action which will lead to a maximization of profits for the firm. The actions toward maximization are further simplified by taking as given the competitive situations in which choices are made.

Thus, in every economic environment except that of semi-monopoly (where there exists a small group of competitors) the firm can act rationally simply by contemplating its own actions and their results without reference to the actions and reactions of its competitors.

At one extreme of the competitive spectrum, for example, lies perfect competition, in which the firm's actions do not significantly affect its competitors or the market; at the other end is monopoly, where the firm is so powerful that it is not affected by the actions of others. In both instances, as in other economically competitive environments, the entrepreneur is aware of the situation that exists, and, by acting rationally, seeks to maximize a determinate and quantitative profit.

The Mythical Entrepreneur

The concept of the firm to the economist is in reality the concept of the entrepreneurial role, which is treated as though it were the firm for purposes of theoretical analysis.⁷ The entrepreneur, as a person or persons, is generally only a figure lurking in the shadow of his actions, although it is his transformation functions that are studied.

The person of the entrepreneur is seen only through his actions, which are rather fatalistically guided by his rational incentive function, which in turn is apparently predetermined (although this is not clear) by technical,

biological, or institutional forces rarely examined by economists.

Economics has established as one of its goals the prediction of firm behavior with respect to prices and quantities (i.e., market behavior), and the entire range of decision-making procedures that are carried on within the firm are not emphasized.⁸ The stress upon market behavior permits economists to substitute the entity of the entrepreneur for the firm and to examine more critically the economic transformations that take place in impersonal exchange or production activities.⁹ In this way it is possible for economists to analyze the firm rationalistically as an acting entity (the entrepreneur) rather than behavioristically as a collective, and to postulate a system of action which is guided unconsciously to the mutual benefit of all parties through the workings of the price mechanism.

Market Behavior Theory

For example, new resources are drawn to the firm and to the seller of resources.¹⁰ A quantity of the firm's production is sold when the price of this output is satisfactory both to the firm and to buyers. Therefore, the economist has evolved a detailed analysis of the entrepreneur unconsciously co-operating with other economic units in market situations which has proved to be extremely useful in explaining firm behavior. However, at the same time the concept of the entrepreneur as the firm has been so enveloping internally that economists have found it extremely difficult to develop a theory of conscious cooperation.¹¹

The economic firm consists, therefore, of a rationally carried out entrepreneurial role in affairs involving prices (costs) and quantities. Finally,

the parameters of action for the firm are established by the predetermined assumption that the entrepreneur possesses a rational incentive function, and that all of the firm's transformations will be influenced only by the unconscious behavior of the price mechanism and the existing state of competition.¹²

The economist's concept of the firm results in conclusions that are generally unsatisfactory to students of other behavioral disciplines. The very behavior patterns which form the content of these other sciences are obscured by the economic focus on the entrepreneurial role, which tends to pull a cloak of darkness around the conscious interdependence of variables internal and external to the firm.

The economic concept of the firm does, however, possess one great advantage which simplifies the study of business behavior. Since the economist assumes that the firm is the entrepreneur, he is able to discuss its behavior as though it consisted of the actions of a single rational organism. He does not have to become involved in the difficult problems inherent in studying the system of persons in—but still separate from—the firm. Hence, we may draw the conclusion that the economic concept of the firm fits well into the rationalistic framework, which in turn is useful for the examination of many problems; but that this concept is not particularly appropriate for the general purposes of analyzing a wider variety of firm behavior.

Gaming Theory— Mathematical Concept

The Concept of the Firm in the Theory of Games. The theory of games is a relatively recent innovation use-

ful for the study of economic, political, and social phenomena.¹³ It is still in the early stages of development, and is continually being enlarged and altered by new applications and new ideas.

One of the useful contributions it has already made, however, is in the construction of a game "terminology" which substitutes a common mathematical vocabulary for many of the difficult and conflicting terms employed in the different social science areas. By examining a part of this terminology we may note the emphasis of game theory, which will help us to develop what might be called a "mathematical" concept of the firm.

The theory of games is primarily concerned with the choices and actions of players in a given situation or game.¹⁴ The firm, of course, is designated as a player; and the conflict or cooperative situation in which it finds itself, and within which it must move, is the game. One particular game is set apart from all others by its rules. The rules in each game prescribe the number of players involved, the state of information possessed by each player prior to a move, and the set of alternatives (which may include those established by chance or "Nature") from which choices may be made. The nature of the moves, whether they are personal or chance, and their order—is also set forth in the rules of each game.

The firm in the theory of games ordinarily is considered as a rationally choosing player confronted by opponents or cooperators in a game defined by predetermined rules. The firm's prescription for action is set forth by its strategy, which is the personal plan of what is to be accomplished by the firm in the course of the game.¹⁵

Strategy

The idea of strategy is one of the important factors that causes the concept of the firm in game theory to diverge from that used in traditional economics. In economics the actions of the firm are limited by impersonal market forces; in game theory strategies and moves are also contingent upon the personal strategies and actions of others, as well as upon chance.

In economics, therefore, the rational firm always adapts itself to a given competitive environment. In game theory the firm has to be adoptive, in the sense that it may continually have to choose a new course of action, as well as adaptive. When the conscious actions of others are inserted into the model the payoff (profit) for the firm depends not only upon its own actions, nor only upon those determined by chance; but it also depends upon the conflicting or cooperative actions of others.

The firm in oligopolistic markets (relatively small number of competitors) is a good illustration of a game situation in which adoption as well as adaption must occur, since the strategies and moves of competitors, as well as the strategy and moves of the firm, will affect the payoff for all players. According to Oskar Morgenstern, in these cases "no maximum problem exists; indeed the notion of a maximum has no meaning."¹⁶ However, if in game theory the notion of maximization in the traditional economic sense fails to apply, what then is it that firms attempt to do?

Flexibility Enhances Payoff

In one of the most common types of game there are two players, each of whom may select a strategy from a

set of alternatives. The total of the payoffs for both players equals a constant sum. However, the payoff to each player may vary with their actions or because of chance. In this simple game the solution for both players is that choice of strategy in which the minimum payoff is higher (or as high) than that offered by any other available strategy.¹⁷

Since through this strategy each player minimizes his maximum loss or risk of loss, this solution is usually termed the "minimax" principle. The firm confronted with this game, therefore, would not necessarily attempt to maximize its profits in the traditional manner; but rather would strive to obtain the greatest profit within the confines of a strategy which minimized its losses. The goal of the firm, even in this simple game, is more limited, and yet more complex than the goal of maximum profits set forth in economic theory.

"Minimaxing" Profits

In certain games, other than the constant-sum game described, the element of uncertainty may be enhanced or lessened, and this in turn may cause the firm to strive toward a goal other than the minimaxing of its profits.¹⁸ Unfortunately, there is at present a lack of agreement upon the usefulness and propriety of other goals in more complex games. For example, it might be assumed that the firms should minimax regret—the difference between actual payoff and maximum payoff which might have been obtained through perfect foresight—rather than loss in games involving uncertainty or ignorance,¹⁹ and it is possible that in some circumstances firms might maximize a weighted average of the minimal and maximal payoffs expected.²⁰

The firm that emerges from an examination of the theory of games is quite a different concept than that which evolves in economic theory. The assumption of rational behavior still remains—in most cases more strongly than in economics—but the relationships that exist between the firm and its competitors or cooperators, its goals, and the state of its information may be substantially different.²¹

Furthermore, the theory of games does not necessarily conceal the internal structure of the firm.²² For example, the entrepreneur may be considered as the host of a countless number of strategies for dealing with a vast variety of business, personal, or chance games that occur endlessly within the firm. At times these games may involve labor disputes, or the allocation of resources to their most efficient destinations, or any situation in which money may be gained as the result of the moves that follow upon the proper choice of strategy.²³

The Firm Grows Wily

The concept or concepts of the firm that may eventually emerge from game theory will include a greater number of variables than that contained in the purely economic model. However, although the promise of the future is bright, the present stage of experimentation with the theory of games has resulted in considerable confusion and ambiguity in the definition of the firm, except in the zero-sum two-person game,²⁴ wherein the firm evolves as a rational player acting to minimax its profits in a personalized duopolistic duel.

In other situations, game theory has not yet crystallized solutions, although it has clarified somewhat the issues

involved in extending the ideas of economic firm behavior beyond traditional boundaries. At the same time, game theory has made the concept of the firm more complex, for it requires that the firm be conceived as possessing remarkable and possibly unattainable reasoning powers.²⁷ The emphasis upon rational strategies, payoffs, the game, and moves in the game, does conform exceedingly well to our category of rationalistic concepts of the firm, however.

Cybernetics

The Concept of the Firm in Cybernetics. Cybernetics has recently become an established region of research and study, and several of its concepts and terms have been found to be useful by scholars who have attempted to apply them to the behavior of the firm.²⁸

Cybernetics originated in the physical sciences, and has contributed substantially to the theory of messages in electrical engineering. Since it is primarily concerned with communication and control, however, its application to the firm soon became evident.

Most of the concepts of the firm that utilize cybernetic ideas and terms consist essentially of "closed-loop" control systems.²⁹ Schematically this type system includes a number of self-contained interdependent variables, of which one or more may be more independent than the others. It usually is affected by some sort of "feedback" process whereby the mechanism is instructed by informational governors that it has missed or reached its goal.³⁰ The most common applications of cybernetics to the firm have also borrowed heavily from—and become confused with—the notions of homeostasis, which were originally em-

ployed to describe the processes by which an organism attained the relative stability it needed for survival.³¹

One of the simplest illustrations of an electrical system with feedback contains the following components: (1) An enclosed space; (2) A heating device (e.g., an electric space heater); (3) A thermostatic control which operates to turn the heater on or off whenever the temperature in the space exceeds certain threshold limits. The thermostat's task is to act as a feedback system which compares the actual heat in the room with the heater's input (the *desired* range of warmth), and which becomes operative as a result of differences between actual and desired temperatures.³² However, there will customarily be some oscillation or "overshooting" because of the time lag between the output of heat and its actual delivery to the enclosure—even with the most efficient thermostat. Cybernetic devices, therefore, always involve a cycle, the amplitude and length of which is dependent upon their efficiencies.

Servosystem Analogy

There are many ways in which this concept of a servosystem may be applied to arrive at a "cybernetic" concept of the firm.³³ For example, the firm may be considered as a "hunting" mechanism, analogous to the thermostat, which is either at, or is consciously searching for, equilibrium. The "command" or equilibrium position for the firm may be described by the desired quantity or value of each balance sheet item.

Any movement away from "ideal" figures sets up conscious (perhaps even habitual) forces which tend to return the firm to equilibrium. When machinery becomes obsolete it is re-

placed; if raw materials are consumed they are replenished—so that the picture of the firm is one of a continually correcting servomechanism which constantly attempts to maintain a balance in the midst of forces of varying intensity which are striving to lead it astray.³²

Its success, furthermore, is dependent upon the efficiency with which it corrects for disequilibrating forces. The firm thus becomes an active combatant in a perpetual conflict situation; but it always plays the conservative role of advocating the status quo of equilibrium; even though it may—because of haste or ignorance—actually overshoot the command positions desired. Finally, although the firm in this conception does not have to maximize, it does have to perform rationally in order to attain its equilibrium status most efficiently.³³

Men Don't Behave Like Machines

Cybernetics as applied to the firm may take several forms, only one of which has been discussed. In all its forms, however, it retains the one big disadvantage which all carry-overs from the physical to the behavioral sciences possess, which is that man's behavior and his institutions are considered to be analogous with the behavior of machinery or matter.

The concept of the firm as a response mechanism is not, of course, limited only to cybernetics and homeostasis, for to some extent this idea prevails even in traditional economic theory. However, by itself the notion of a self-adjusting or deliberately-adjusting organism is meaningless, for even in the case of the thermostat it is evident that outside forces must establish the command position toward which the mechanism tends.

So too in the firm, the equilibrium position of all balance sheet items must be established. Unless the explanation of the system includes an explanation of how the command position itself originates it must of necessity be incomplete. Thus, the application of cybernetics to the concept of the firm, while providing a framework that may be useful, omits what many behavioral scientists would consider the most salient feature of the firm in this context—namely, how equilibrium is established.³⁴

Other Rationalistic Concepts. Our discussion of rationalistic models of the firm is not intended to be all-inclusive, but merely to illustrate a certain type of concept. In all these the common thread of a single acting organism, of de-personalization, and the threads of other mutual ideas combine to form at least a thin strand that holds all rationalistic concepts of the firm together.

It is not essential, furthermore, that a concept be rationalistic originally for it to be included in this category. Papandreou, for example, believes that the concept of the firm in economics reflects the action frame of reference developed by Talcott Parsons and others.³⁵ We would tend to think that Parsons would consider his theory to be behavioristic, for while the emphasis in this frame of reference is placed upon action, which is that relationship between the organism and things external to it,³⁶ he has stressed:

"It is actors in situations who act...; organisms in environments have activity. In other words, that which impinges upon our senses and which our measuring instruments record is the activities of organisms in environments; what we deal with on the scientific level are the actions of actors in

situations, which are abstractions in terms of principles of relationship.³⁷

Organismic Approach

This statement implies that although it is action upon which the focus of social science should center, action cannot be examined effectively without reference to personalized actors and a broad environmental field for action. The Parsonian action frame of reference is more behavioristic than rationalistic, for it involves needs which a cognitive, cathectic, and evaluative actor attempts to satisfy by striving toward goals.

It uses as parts of its structure the essentials of culture, personality, and social studies. The economic concept of the firm, therefore, was not built to "fit the specifications of this frame of reference,"³⁸ although there is nothing inherently wrong with trying to make it fit into this superstructure.³⁹

Through the construction of the action edifice to hold the economic concept of the firm we do, however, twist a behaviorist concept into the rationalistic mold. Kurt Lewin's field theory,⁴⁰ or more specifically, the terms and methodology of his behaviorist theory, also appears on the verge of being used to forge a rationalistic concept of the firm.⁴¹ Other theories that originally were conceived as behaviorist have been, or may eventually be, applied rationalistically.⁴²

While there is nothing basically unscientific about this procedure, it does indicate some of the problems of categorization of concepts that exist, and the multiple uses that might be made of certain theories.

The physiological theories of the scientific management school, founded by Frederick W. Taylor, produce a concept of the firm that conforms to

the patterns established by our rationalistic framework. The firm in these theories is conceived primarily as a relatively simple machine-process oriented rationally toward the goals of profit maximization.⁴³

Scientific Management School

However, the scientific management school of thought did have behaviorist overtones, for it was not interested specifically in the actions of the universal set that was the firm: rather its attention was directed internally toward the tasks performed by the human and mechanical machines that compose the sub-sets within this universe.

The elements in each sub-set (whether human or mechanical or both) were delineated chiefly in neurophysical terms to ascertain their efficiencies in performing specific acts. The worker (especially in the early years of the study of scientific management) was regarded as a muscular bundle of energy, defined in terms of his effort, speed, cost, and susceptibility to fatigue.

In the same way that all of the other concepts of the firm came to exist as a convenience for specific areas of study, so too was the scientific management concept the result of problems that Taylor and his cohorts attempted to solve. The engineering approach to efficiency, however, so limited investigation and research to mechanical and physiological variables that it has been almost abandoned today by persons with an interest in behavior.⁴⁴ The failure of the laws of physical science to be applied in their entirety to the actions and behavior of persons has been recognized more fully in this area than in perhaps any other field where such analogies prevail.⁴⁵

Behaviorist Concepts of Firm

The concepts of the firm discussed under the general heading of "rationalistic" contain common themes, since they stress the impersonal movements of an organism operating toward a specific goal in an environment that is objectively defined. In this section we shall present illustrations of alternative formulations of the idea of the firm, to which we have attached the term "behavioristic."

The behavioristic frame of reference usually consists of concepts which have the following features in common: (1) The assumption that it is actors within the firm, rather than the firm itself, that act; (2) That behavior is conditioned by personality as well as environmental factors; (3) That, as a minimum, the behavioral processes examined must take into account the cognition, perception, beliefs, and knowledge of the actor(s); and (4) That rewards, or goals, are oftentimes complex.

The behaviorist framework, therefore, encompasses a much wider area within which concepts of the firm may be established. However, it does not always succeed in freeing itself completely from rationalistic notions. For example, it is possible to construct a behaviorist model of the firm that utilizes the theory of games or of cybernetics, although the variables that would be included in such a model would range beyond the parameters noted in the concepts of the firm discussed earlier. Perhaps the most satisfactory method of bringing out the differences between rationalistic and behaviorist concepts is to present illustrations of the latter. Before this material is introduced, however, we should

attempt to clarify one source of confusion that might arise.

We have already pointed out that the principal difference between the rationalistic and behaviorist categories is that the former considers the firm as an acting entity, while the latter conceives of the firm as composed of actors.

Gestalt of the Group

This is not to imply, however, that behaviorist concepts cannot treat of the group or the total firm. The essential difference between the two concepts is not that one is limited to an examination of individuals and the other to a study of aggregates; rather it lies in the manner in which the aggregates are analyzed. The rationalistic approach attributes to the aggregate a type of Gestalt quality; it creates a group mind, a singleness of character, an additional entity.

The behaviorist category includes no such mystical quality when it considers aggregates such as the group or the firm. Behaviorists may describe the group and talk about its common features (its leadership, sub-groups, interactions, etc.), but only on a non-mystical, empirical, and testable basis. As such they may describe the firm and its goals and nature as different from those of the individuals in it, but not as a rational entity with its own mind, as seems to be the case in rationalistic studies of the firm.⁴⁰

Is It Bureaucracy?

The Firm as a Bureaucratic Organization. Students of bureaucracy have formulated several theories which, when related to business activities, result in a number of closely allied concepts of the firm. We shall examine briefly the works of three of these

scholars, Max Weber, Robert K. Merton, and Phillip Selznick, abstracting from their remarks on bureaucratic organizations those ideas which appear most germane to our production of concepts of the firm.

These concepts contain the common notion that firms are adaptive, or functional, organizations; although two of the theories (Merton and Selznick) contain dysfunctional elements which retard the tendency of firms to adapt themselves to their environment.

Weber's View

Weber's theory of bureaucracy is based upon his efforts to ascertain and abstract those elements which he believes are essential to all bureaucratic organizations, regardless of the time or culture in which they exist.⁴⁷ The "ideal-type" bureaucracy that emerges as Weber's universal, and which we may consider as his basic concept of the firm, is one of functionally linked offices arrayed in hierarchical order.

In each office are occupants whose behavior is restricted and directed toward common goals by general rules.⁴⁸ Important to Weber's theory is the existence of rules which codify behavior in each office of the organization.⁴⁹ Although Weber does devote some of his discussion to individuals within the bureaucracy, and to their relationships to each other and especially to their offices, he is primarily interested in the bureaucracy (firm) as a functional structure, which he considers to be bound together by rational laws into an organization that is superior to other organizational types and to individuals.

The efficient ranking of administrative offices autocratically controlled by functional rules, filled with specialists

who are highly skilled, and operating continuously with traditional principles of the division of labor, free selection process, etc., represent to Weber the highest type of organization. Thus, to some extent Weber's concept resembles that advanced by F. W. Taylor, for he considers the firm as the ideal framework within which specialized skills are most satisfactorily adapted to attain the goals of precision, reliability, and efficiency.

Merton on Bureaucracy

Robert K. Merton's theory of bureaucracy, in many of its features, follows closely the concepts advanced by Max Weber.⁵⁰ The emphasis on the desirability of functional relationships between actions, offices, and organization goals; the hierarchy of offices; pre-existing rules; formality of relationships—all these are similar to the ideas set forth by Weber. Merton extends these concepts, however, by dividing functions into two classes: (1) manifest functions, which are intended adjustments recognized by persons in the organization; and (2) latent functions, which are neither intended nor recognized.⁵¹

He also stresses the dysfunctional aspects of bureaucracy, which are those consequences that reduce the adaptability of the organization. The concept of the firm that results from this elaboration is not as "ideal" as that which was perceived by Weber. The rules established by the top-hierarchical offices to effect reliable and predictable behavior among those of lesser status lead to an increase in conformity, impersonality, and ritual; and to a decrease in innovation.⁵²

In other words, Merton emphasizes that an organization in which functionalism is the goal will produce dys-

functional and latent functional by-products which will tend to create barriers to the achievement of goals. The firm in Merton's image becomes a field for conflict and rebellion. This picture is carried one step further in Phillip Selznick's concept.

Selznick's Concept

Selznick also views the firm as a formal organization attempting to mobilize its human and technical resources toward stated objectives.⁵³ The individuals employed by the firm are conceived as means to an end. They resist this role strongly, and attempt to substitute their own purposes and problems for those of the firm. The internal conflicts that occur between organizational sub-units are paralleled by the pressures bearing upon the firm from external environmental (e.g., political, legal, social) forces.

One obtains from Selznick the picture of the firm as a sort of an organizational bathysphere, moving through the water-like environment which presses upon it from without; and filled with air-like pressures which tend to explode or collapse its organization, or at least to alter its symmetrical shape. Under such conditions the firm, to survive, must adapt itself to hostile situations fraught with dangers.

Adaptive Behavior of Firm

One way in which it does so (apparently after resisting strongly) is to follow the dictates of the adaptive individuals within it, who form informal groups with informal lines of communications. As Selznick points out, organizations may be examined within a framework of needs and self-defensive mechanisms.⁵⁴ The entry of fresh needs into the firm and the develop-

ment of systems for self-defense results in alterations to the organization.⁵⁵

Common to all of these bureaucratic descriptions of organization is the view that the firm (or more specifically the large corporate organization) is a highly organized functional institution that in some way has an existence apart from the individuals that populate it. The attempt to advance the purposes of the organization, which in Weber's schema brings about a harmonious structure, in Merton's and Selznick's theories results in unintended and undesired individual and group behavior.

Organizational School

Organizational Concepts of the Firm. During the years since 1940 an ever-increasing stream of ideas has been forthcoming from authors who belong to what we may loosely classify as the "organizational" school of thought. This stream is by no means completely coadunated, but rather has been diffused by such inter-related tributaries as human relations, administrative science, and organization theory.⁵⁶

Furthermore, the source of this stream springs from a coalescence of the behavioral sciences, with some stress upon economics, anthropology, and political science; but with the major emphasis upon psychology and, in particular, sociology.

Sociological Pattern

Organizational concepts of the firm, therefore, vary considerably in their details. The majority of these, however, appear to possess at least three features in common: (1) The concept of the firm as a complex *pattern* of personal relationships rather than a framework in which actors perform;

(2) The omission of the traditional assumption of strict rationality, and its replacement with any one of several types of qualified assumptions of rationality;⁵⁷ (3) The assumption, often only implicit, that the firm is a homeostatic socio-economic organization with the underlying goal of survival.

In order to illustrate how the organizationalists view the firm we shall in this section present three concepts: the first constructed from the work of Chester Barnard, who is representative of what we might call the "traditionalist" school; the second based upon the writings of Burleigh Gardner, who is principally a human relationist; and a third represented by Herbert Simon, who is a prominent scholar of the science of administration. While each of these concepts of the firm will differ somewhat from the others, they will also contain many similarities, for they are all part of the mainstream of organizational thought.

Barnard, Traditionalist

Chester Barnard regards the firm as a cooperative system, which he defines as "a complex of physical, biological, personal, and social components which are in specific systematic relationships by reason of the cooperation of two or more persons for at least one definite end."⁵⁸ The elements basic to every firm (and, for that matter, to every organization) are (1) communication; (2) willingness to serve; and (3) common purpose.⁵⁹

From the nature of these three essentials it is evident that Barnard conceives of the firm as a system of conscious cooperation wherein components act and react upon one another and upon the environment in communicative patterns. It is recognized that in all organizations the

willingness to serve of most participants will be positive, but slight; and that this willingness will be a function of the net inducements offered to each participant.

The common purpose of the firm is not necessarily identical to the motives of individuals within it. However, while each individual may be motivated by different forces and to different degrees, the purpose of their *act of cooperation* is common to the organization and vital for its survival.⁶⁰ Common purpose is the coordinating and unifying force of the firm, and is dispersed through communications to those with a personal willingness to serve in the firm.⁶¹ The executive, or executives, of the firm becomes the center of communications, coordinating the components of the organization, and exercising authority to weld these components into the cooperative system that is the firm.

Corporate Equilibrium

Finally, underlying Barnard's thesis is the idea that a firm requires a proper combination of the three elements of communications, willingness to serve, and common purpose in order to survive. An equilibrium state must exist both externally, between the firm and its environment, and internally, between the organization and individuals.⁶² Barnard points out that these external and internal equilibria may vary with the environment, and that "when one is varied compensating variations must occur in the other if the system of which they are components is to remain in equilibrium, that is, to persist or survive."⁶³

Gardner, Human Relationist

Burleigh Gardner conceives of the firm as a miniature social organization

reflecting, and operating in, the environment of a larger society.⁶⁴ His emphasis, like Barnard's, is upon the pattern of relationships that tie the actors in this microcosm together, rather than upon the organization or the actors themselves. It is this pattern and its fluidity which affects both individuals and the totality that is the firm.

In fact, it is this kinetic pattern of human relationships that is the firm. The total pattern is composed partly of formal relationships, and in part made up of diversified informal patterns of relationships. These informal patterns, which emerge spontaneously, exercise a powerful control over individuals in the firm.⁶⁵

Status

The total pattern that is the firm also includes a complicated set of status systems established formally, and by sex, age, position, pay, kind of work, etc.⁶⁶ Most of these status systems are reinforced by symbols of superiority. There exist also complex boss-man relationships. This whole societal complex is held together by an imperfect system of communications.

As an externally static but internally fluid organism the firm is difficult to comprehend in its complex entirety. This difficulty, moreover, is compounded by the external environment and by internal shifts and changes which bring pressures for further changes to bear upon the firm. Gardner presents a homeostatic notion of the organization resisting these pressures to change, or in some cases adjusting to change, in an effort to maintain its social equilibrium.⁶⁷

Closely related to Gardner's—and especially to Barnard's concept—is the notion of the firm advanced by Her-

bert Simon. Simon, however, has extended, revised, and altered Barnard's thesis, and has elaborated upon it in a number of ways. The firm still remains a "complex pattern of communications and other relations in a group of human beings."⁶⁸ This pattern still affects the goals, informational flows, and attitudes of each participant, and shapes for each a set of stable and understandable expectations of interactions within the firm.⁶⁹

Simon, like Barnard and Gardner, remains interested in viable solutions which permit survival of the firm.⁷⁰

He too believes that the willingness to serve of each member of the firm (and thus the glue that holds the firm together) is dependent upon the net inducements offered to each member, which must be positive.⁷¹

Simon's Homeostatic Firm

However, much of Simon's unique contribution to organization theory has been directed toward the question of rational behavior and maximization. He rejects the notion of omniscient rationality attributed to the entrepreneur by economists, and substitutes for this an idea of limited or bounded (but intended) rationality. This concept Simon has set forth in the following passage:

"Administrative man recognizes that the world he perceives is a drastically simplified model of the buzzing, blooming confusion that constitutes the real world. He is content with this gross simplification because he believes that the real world is mostly empty—that most of the facts of the real world have no great relevance to any particular situation he is facing, and that most significant chains of causes and conse-

quences are short and simple. Hence, he is content to leave out of account those aspects of reality—and that means most aspects—that are substantially irrelevant at a given time. He makes his choices using a simple picture of the situation that takes into account just a few of the factors that he regards as most relevant and crucial.⁷²

Simon has elaborated upon these points in a variety of publications, and from them has constructed his own concept of the firm.⁷³ Briefly, this firm may be described as a pattern of relationships among individuals, none of whom act with perfect rationality, but all of whom attempt to be as rational as possible within the limits set for them by their personalities and by the environment.

Decision-Making Machine

The firm becomes an imperfect decision-making machine, forced to choose from alternatives continually without knowing exactly what the results of each choice will be. Under such conditions it becomes evident that men in business cannot *know* the best alternative in all cases where choices must be made; they cannot, therefore, maximize. What businessmen must strive for is not maximum profits, but rather for behavior patterns that produce satisfactory conclusions. In other words, the firm (or rather that organization of decisions and actions that is the firm) cannot maximize profits; it can only *satisfice*.⁷⁴

The work of Simon is constructed more upon the postulates of psychology and biology than are the writings of either Barnard or Gardner, and thus the notion of the homeostatic firm is brought out more clearly. Simon, for

example, has compared the firm to the rather blind probing of an animal in a maze to satisfy his minimal requirements for survival. He has also been influenced by communications theory to incorporate the importance of the number, nature, and behavior of relay points (decision-making units) as factors significant for his concept of the firm.

Concepts Often Conflict

The importance of organizational theories, and their application to the business concern, has become widely recognized during the past decade, and more work has been, and is being, conducted in this area of business theory than in any other. At present, however, the field is not highly organized, and the concepts that have been forthcoming are diverse and somewhat conflicting.

It is evident that these concepts rest more securely upon a base of reality than do, for example, the economic notions of the firm. In addition to the problems that exist among the organizational theorists because of their lack of agreements on several issues, there are also other difficulties with their concepts of the firm.

To mention only a few of these: it is evident that these theories are relatively complex, and include a large number of variables which, while making them more realistic, tend to make them untractable for prediction purposes. It is also apparent that these concepts make the firm a less systematic organization than is frequently found in real life.

Finally, the goal of "satisficing" (or even of viability) is not clearly delineated, nor is it backed by empirical evidence of firm behavior. Nevertheless, it is possible that these studies of or-

ganizational behavior may help to bridge the gap between traditional theories and more satisfactory concepts of the firm which are as yet unknown.

Still Other Behaviorist Concepts of the Firm. There are many, many variations of sociological, psychological, and other concepts that we could apply to the firm in order to note the framework or background in which theories of behavior operate. A few deserve mention here, either because they have been influential, introduce a different terminology, or reflect in some way an important school of thought. Even with the addition of these, however, our list of behaviorist concepts still remains far from complete.

Margolis' Deliberative Firm

In recent years a number of articles have tried to mingle the economic and various behavioristic theories of the firm. One of these, advanced by Professor Margolis of California, may be taken as illustrative, and is of interest because of the debate that followed its publication.⁷⁵ Briefly, Margolis rejects the economic concept of the firm, stating that "it does not explain non-profit maximizing goals and business rules observed in practice which arise in part because of the existence of uncertainty."⁷⁶

His concept of the firm, which is termed a "deliberative" model, assumes limited knowledge and profits satisfactory to management's "aspiration level," which means essentially that profits in each period must be equal to or greater than current profits. Furthermore, firms will prefer alternatives which tend to minimize uncertainties; e.g., within a "satisfactory" profit constraint they will produce dif-

ferentiated products rather than manipulate prices.⁷⁷ Margolis, then, is seeking a framework within which the decision-making process may be understood.⁷⁸

Bodenhorn's Dissent

Professor Bodenhorn of Chicago has criticized Margolis' paper on the grounds that economic theory is concerned with market behavior, not decision-making, and Margolis' statements are therefore irrelevant.⁷⁹ In so doing, Bodenhorn points out that traditional economic theory actually consists of alternative theories, each of which is only "sometimes" applicable.⁸⁰ However, there is little reason, if one broadens this argument, why Margolis' theory (or any other—or every other, for that matter) cannot be also "sometimes" applicable, and all therefore become trivial.

Kluckhohn's Role Theory

Role theory is an area in which the analysis of behavior of groups by sociologists and the analysis of the motivation of individuals by psychologists has overlapped. As applied to the firm, role theory resembles in many respects the bureaucratic and organizational concepts already discussed. For example, the following quotation from Clyde Kluckhohn and Henry A. Murray's *Personality in Nature, Society, and Culture*, which defines the firm and explains the notion of the "role," brings out these similarities:

[The firm is] . . . a series of integrated offices, in which are a number of obligations and privileges closely defined by limited and specific rules. Each of these offices contains an area of imputed competence and responsibility. Authority, the power of control which derives from an

acknowledged status, inheres in the office and not in the particular person who performs the official role.”⁸¹

While the idea of a role was originally attributed to dramatic parts, it is evident that these men “perform” according to their positions. Thus, if we consider the firm as an aggregation of roles, and if we can understand the wide band of behavior forced upon actors by these roles, then we may be able to understand the behavior of the firm.

For example, through the use of a modified “role” analysis, Everett C. Hughes has speculated that executives tend to conform to expected rituals placed upon them by their roles.⁸² In this way they escape judgments and seek “stable and safe” solutions rather than those alternatives which might increase profits substantially.

Neal Gross and others in *Explorations in Role Analysis* have evolved a theory of roles which may be useful for predicting firm behavior.⁸³ Under role theory, therefore, we would have to consider the firm as a complex of “roles,” with the emphasis upon relationships between offices rather than between individuals. Unfortunately, there appears to be considerable latitude for individual behavior within the framework of a “role,” and it is doubtful that this type of analysis will ever be sufficiently refined to enable us to use it for narrow predictions.

“Activity, Interaction, Sentiment”

A concept of the firm that resembles that set forth by Talcott Parsons and others is the idea of small groups that is found in the work of George C. Homans.⁸⁴ We could conceive the firm, in Homans’ terms, as possessing three major attributes. These are: activity,

which is what the members of the firm do as members; interaction, the relationships between members of the firm; and sentiment, which is the additive total of the individual group-member’s feelings towards the group’s activities. The three elements of group behavior, furthermore, are directed toward any situation by a “norm,” which is a code of behavior; and take place within “external and internal systems,” which are the relationships between the group and its external environment and toward one another.

Dynamics of the Group

Bernard De Voto, in his foreword to Homans’ *The Human Group*, has summarized this succinctly:

“What the small group reveals when thus studied is a social system reacting with its environment as a self-adjusting organization of response whose parts are mutually interdependent. What acts, and what reacts, is not any single part or function of the social system, nor any combination of parts or functions, but the system as a whole, a totality whose mutual interdependence is the system. Cause and effect disappear; what must be looked for is the resultants of complexes of interacting forces. The group is a dynamic social equilibrium. It sets up its own responses organically, determines its own measures of control, derives its own possibilities of adaption, elaboration, and change.”⁸⁵

Homans’ notions of the firm, therefore, are also much like those of the organizational theorists. While his remarks are confined only to small groups, and are based upon the empirical studies made of five such groups, it would appear that they could be

applied to firms of any size, at least in their essentials.

What About the Individual?

Common to many students of business, and especially to those with a psychological bent, is a concentration upon the individual and his motivations rather than upon the group or the total firm. The concept of the firm that often arises from the writings of these individuals is that of an organization conflict.

Persons within organizations all have ego wants that are formulated in early training and by the social mores of a culture. These are prestige wants, ability and domination wants which presumably enable the individual to attain more satisfactory id goals of a more fundamental nature.

On the other hand, the individual also has superego wants which dictate that he submerge himself in the group with which he is identified. Here too the goal is satisfaction of the id desires. The conflict between the ego, which demands prestige, and the superego, which desires conformity, tends to lead to a multiplicity of goals, to insecurities, and a feeling of entrapment.⁵⁷

That Trapped Feeling

Frequently, however, such conflicts between the ego and the superego endow the individual with an enlarged ego which has as its goal the success and prestige of the group. Thus the successes and failures of the group become the successes and failures of the individual.⁵⁸ The firm, in these circumstances, becomes primarily a symbol of relationships between men that are identified with it; and the participants then work toward a common end that is established for them by society.

In this article we have tried to point

out that there are many concepts of a business firm, and that these concepts depend primarily upon the purpose for which they are used. Whether we consider the firm rationalistically or in behaviorist terms, whether we regard it as an economically productive unit or a social organization, or in some other fashion, is contingent upon the type of business behavior in which we are interested, and which we are trying to explain or predict. The firm is not the only institution, nor the only thing, that may be viewed differently from a variety of angles by people with different backgrounds and different skills.

For example, there is a passage in one of Theodore Dreiser's novels, in which the following fictional conversation between a man and a little girl is recorded:

"What's water?" he would ask; and being informed that it was "what we drink," he would stare and say, "That's so, but what is it? Don't they teach you any better than that?" "Well, it is what we drink, isn't it?" persisted Vesta (the little girl). "The fact that we drink it doesn't explain what it is," he would retort. "You ask your teacher what water is;" and then he would leave her with this irritating problem troubling her young soul.*

Conclusions

In almost the same way we shall have to leave the concept of the firm, for what the proper or correct concept is still remains an irritating problem. We may, however, point out a few of the features that these notions possess that are significant for further investigations.

First, as we go through the various explanations of firm behavior, we can understand them more satisfactorily if

we are aware of the frame of reference that they employ, and of the concept of the firm that they utilize.

None of these concepts has general validity, none of them is perfectly realistic. Their virtue lies not in these features, but rather in their usefulness in providing a model within which the theory of behavior that is expounded may be best set forth. How useful each concept of the firm is for the theory it contains; and how helpful it is in solving the problems postulated are matters which the reader must judge for himself.

Perfect Concept Still Evolving

Second, none of the concepts of the firm we have examined in this paper are eminently suitable for the student of business—and yet, at the same time, all are important. If we are ever to produce business scholars (not economists, sociologists, psychologists, etc., with an interest in business) then it is

possible that some day some sort of eclectic model of the firm will evolve. In the meantime, however, we must be satisfied with looking at the firm in a non-cohesive manner, from all angles, so that we may better be able to understand it and to explain its behavior.

The problem of the "proper" concept of the firm need not be troublesome to executives, however, for it is analogous to a type of problem which confronts businessmen every day, one in which there may be more than one correct solution. As Harold L. Johnson has written: "With this approach to the basic nature of theorizing, the error of pseudo-simplicity is avoided wherein it is stated that if one model is useful or "true" others are thereby "false" or unnecessary. In view of the great diversity of business behavior, "both-and" rather than "either-or" appears to be the most valid conception of theory construction."⁵⁰

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2. For further comments on these differences see the debate between Rutledge Vining and Tjalling C. Koopmans in the *Review of Economics and Statistics*, XXXI (1949), 77-94. Also of interest in this regard are the remarks by Kenneth J. Arrow, "Mathematical Models in the Social Sciences," in Daniel Lerner and Harold D. Lasswell, eds., *The Policy Sciences* (Stanford: Stanford University Press, 1951), especially pp. 133-4.
3. See note 2, Arrow, p. 134.
4. See note 1, pp. 112-20.
5. This term originates in work carried out under the auspices of the Cowles Commission and is used, for example, by Jacob Marschak, "Organized Decision-Making," *Cowles Commission Discussion Paper, Economics*, No. 2034, Feb. 29, 1952; and T. C. Koopmans, *Activity Analysis of Production and Allocation*, Cowles Commission Monograph No. 13, New York and London, especially pp. 93-5.
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7. See especially, James H. Stauss, "The Entrepreneur: The Firm," *The Journal of Political Economy*, LII, No. 2 (June, 1944), 112-27.
8. D. Bodenhorst, "A Note on the Theory of the Firm," *Journal of Business*, XXXII, No. 2 (April, 1959).
9. Cf., Kenneth E. Boulding, *Economic Analysis*, 3rd Edition (New York: Harper & Brothers, 1955), Chapter 25.
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11. See the comments by R. H. Coase, "The Nature of the Firm," *Economica*, New Series, IV (1937), 386-405. Reprinted in: G. J. Stigler and K. E. Boulding, eds., *Readings in Price Theory*, Published for the American Economic Association, VI (Chicago: Richard D. Irwin, Inc., 1952), 331-51.
12. The "linear-programming" concept of the firm is not too different in its essentials from that employed by economists, and therefore will not be treated in this article. For a description of this concept, see: Robert Dorfman, Paul A. Samuelson, and Robert M. Solow, *Linear Programming and Economic Analysis*, The RAND Series (New York: McGraw-Hill Book Company, Inc., 1958), pp. 130-33.
13. See: John Van Neumann and Oskar Morgenstern, *Theory of Games and Economic Behavior* (Princeton: Princeton University Press, 1944). This book is generally regarded as the innovating contribution on the theory of games. Like every other new theory in the social sciences, however, it had apparently been anticipated by someone else—in this case by Emile Borel in the 1920's. See: M. Fréchet, "Emile Borel, Initiator of the Theory of Psychological Games and Its Application," *Econometrica*, 21 (1953), 95-96.
14. Game theory may also be employed in a variety of ways that differ from the way it is described here, but still be pertinent to firm behavior. It may, for example, be concerned with individual behavior under uncertainty, and with allied matters. As an illustration see: Leonid Hurwicz, "What Has Happened to the Theory of Games," *American Economic Review*, XLIII (May, 1953), No. 2, 398-405. For an example wherein the terminology of game theory has been most useful, see: Karl-Olof Faxen, *Monetary and Fiscal Policy Under Uncertainty*, Stockholm Economic Studies, New Series I (Stockholm: Almqvist & Wiksell, 1957), especially the use of partition trees and strategies in Chapter III.
15. A strategy may be thought of as the set of rules for one player wherein he takes into account all contingencies in planning all his moves during the course of the game. For example, if you were in charge of public relations for a political candidate in a two-man election race, your opponent's campaign manager would have a possible set of responses to your first move. You in turn would plan alternative actions depending upon his response to this first move, etc. Obviously strategies can be statistically ascertained only in the simplest games.
16. Martin Shubik, *Strategy and Market Structure* (New York: John Wiley & Sons, Inc., 1959), Foreword by Oskar Morgenstern, p. viii.
17. Von Neumann and Morgenstern, see note 13, Chapter III and especially Chapter IV, pp. 169-78.
18. When uncertainty is introduced in varying degrees into the theory of games, the line of demarcation between this theory and statistical-decision theory becomes extremely tenuous, so that the concept of the firm as used by students of statistical-decision

theory will not be considered separately herein. For example, the classic reference to statistical-decision theory is Abraham Wald, *Statistical Decision Functions* (New York: John Wiley & Sons, Inc., 1954), in which the formulation of statistical-decision theory is very similar to the playing of a game against nature.

19. L. J. Savage, *The Foundations of Statistics* (New York: John Wiley & Sons, Inc., 1954). "Regret" is the difference between the actual payoff and the payoff that might have been obtained with perfect foresight.

20. Leonid Hurwicz, "Some Specification Problems and Applications to Econometric Models," (abstract) *Econometrica*, XIX (July, 1951), pp. 342-4.

21. In games where there is a lack of communication among players, rationality might be sacrificed. See: J. F. Nash, "Non-Cooperative Games," *Annals of Mathematics*, 1951, pp. 286-95.

22. One of the first explorations of administration using the terminology of the theory of games, although he later denied that he consciously utilized game theory in this book, was made by Herbert A. Simon, *Administrative Behavior*, 2nd Edition (New York: The MacMillan Company, 1957).

23. Ward Edwards, "The Theory of Decision-Making," *Psychological Bulletin*, 51, No. 4 (July, 1954), 406.

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28. Weiner, *The Human Use of Human Beings*, see note 26, pp. 58-9.

29. Walter B. Cannon, *The Wisdom of the Body* (New York: W. W. Norton and Company, Inc., 1932), p. 24. The term "sociostasis" has been suggested where the application is to social systems, see: G. A. Lundberg, "Human Social Problems as a Type of Disequilibrium in a Biological Integration," *American Sociological Review*, XIII (December, 1948), 689-99.

30. Cf. H. M. James, N. B. Nichols, and R. S. Phillips, eds., *Theory of Servomechanisms*, M. I. T. Radiation Laboratory Series (New York: McGraw-Hill Book Co., 1947), p. 62.

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32. Cf., Kenneth E. Boulding, *A Reconstruction of Economics* (New York: John Wiley & Sons, Inc., 1950), especially Chapters 2 and 17.

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35. Papandreou, *op. cit.*, p. 183.

36. See: Talcott Parsons, *The Structure of Social Action*, 2nd Ed. (Glencoe, Ill.: The Free Press, 1949), especially pp. 43-51 and 732-33 for his position on the theory of action.

37. Talcott Parsons and Edward S. Shils, eds., *Toward a General Theory of Action* (Cambridge: Harvard University Press, 1952), p. 31.

38. Papandreou, *op. cit.*, p. 183.

39. Parsons and Shils, *op. cit.*, p. 28. The authors point out that although economic theory has its conceptual foundations in action theory, in effect its differences are substantial.

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41. Lewin's theories have apparently been of special interest to marketeers. See the essays by Joseph Clawson and Wroe Alderson in: Reavis Cox and Wroe Alderson, eds., *Theory in Marketing* (Chicago: Richard D. Irwin, Inc., 1950), pp. 41-89.

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44. Cf. Gore and Silander, see note 1, p. 113 for qualifications of this statement.

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46. Cf., Kurt Lewin, "Experiments in Social Space," *Harvard Educational Review*, IX (1939), 22-4. Reprinted in: Kurt Lewin, *Resolving Social Conflicts* (New York: Harper & Brothers, 1948), pp. 72-4.

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49. Cf., Alvin W. Gouldner, "Discussion of Industrial Sociology," *The American Sociological Review*, XIII (1948), 396-7.

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53. See: Phillip Selznick, *TVA and the Grass Roots*, University of California Publications in Culture and Society, Vol. III (Berkeley: University of California Press, 1949). More complete for our discussion is Phillip Selznick, "Foundations of the Theory of Organization," *American Sociological Review*, XIII (February, 1948).

54. Phillip Selznick, *TVA and the Grass Roots*, *op. cit.*, pp. 251-2.

55. March and Simon, see note 34, Chapter 3, especially pp. 34-47. This chapter contains some interesting comments and diagrams on these and other theories of bureaucracy.

56. Cf., Gore and Silander, see note 1, pp. 101 ff. These authors appear to divide organizational theories into the two classes of traditional and behaviorist.

57. Often rationality is attributed to executive members of the firm, and the qualities of passivity or manipulability are given to all other firm members.

58. Chester I. Barnard, *The Functions of the Executive* (Cambridge, Mass.: Harvard University Press, 1956), p. 65.

59. *Ibid.*, p. 82. Compare Barnard's essential elements with those set forth by Alderson, note 41, pp. 68-74, where (1) compency, (2) seriality, and (3) concurrence are basic to every organization.

60. Barnard, note 58, pp. 86-9.

61. *Ibid.*, pp. 94-5.

62. *Ibid.*, p. 83.

63. *Ibid.*

64. Burleigh B. Gardner, "The Factory as a Social System," in William Foote Whyte, ed., *Industry and Society* (New York: McGraw-Hill Book Company, Inc., 1946), Chapter II.

65. One of the best studies on informal groups is summarized in: William Foote Whyte, "Corner Boys: A Study of Clique Behavior," *American Journal of Sociology*, 46, No. 5 (March, 1941), 647-64.

66. See: Chester Barnard's chapter in Whyte, *Industry and Society*, *op. cit.*, pp. 46-83, for a good discussion of status systems in the firm.

67. Gardner, note 64, pp. 14-15.

68. Herbert A. Simon, *Administrative Behavior*, 2nd Edition (New York: The MacMillan Company, 1957), xvi.

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71. *Ibid.*

72. Simon, *Administrative Behavior*, note 68, pp. xxv-xxvi.

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80. *Ibid.*

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82. Everett C. Hughes, "Institutional Office and the Person," *American Journal of Sociology* (November, 1937).

83. Neal Gross, Ward S. Mason, Alexander W. McEachern, *Explorations in Role Analysis* (New York: John Wiley & Sons, Inc., 1958).

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85. Foreword by Bernard De Voto, *ibid.*, p. xv.

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89. Harold L. Johnson, "A Behavioral Approach to the Business Enterprise," *The Southern Economic Journal*, Volume XXVII, Number 1 (July, 1960), 1-2.

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BUSINESSMEN'S CONCEPTS OF "INJURY to COMPETITION "

ROBERT C. BROOKS, JR.

Injury to a competitor is not always the equivalent of injury to competition. Awareness of this, and the ability to distinguish one from the other, can forestall much useless litigation. Here is a set of basic questions designed to serve as a yardstick to help the business community identify and measure true injury to competition.

Is there a valid distinction between "injury to competition" and "injury to a competitor"? It has been frequently stated that the Federal Trade Commission has confused the two types of injury in its enforcement of the Robinson-Patman Act,¹ and has ignored the fact that injury to individual competitors is to be expected as a necessary element of healthy and vigorous competition.²

What is the thinking of the business community regarding these two types of injury, and is there a distinction between them in the eyes of businessmen? The answers might not only throw light on the manner in which the Robinson-Patman Act should be enforced, but might suggest an ap-

proach toward greater consensus of opinion that would materially help in self-enforcement of the law.

If the extent of litigation could be reduced, it would free both the regulatory agency and the business community for more productive work. Furthermore, most businessmen believe that competition is vital to the proper functioning of our economic system. Our public policy of promoting competition is often cited as one of the key reasons for the superiority of American, as opposed to European, economic performance.

For purely ideological reasons, and apart from possible violation of the law, a businessman might wish to avoid actions which injure competi-

tion. But the businessman must find an acceptable basis for distinguishing injury to individual competitors from injury to competition.

Unless the distinction is properly made, he may, simply because a competitor would be hurt as a result, curtail actions which would actually improve the vigor of competition. Alternatively, the businessman should avoid the error of concluding that competition is not injured by his actions, simply because none of his competitors in the market are thus injured.

Views Differ With Interests

It would, of course, be unrealistic to expect a single viewpoint on this question—or any other question—from a group as diverse as that which makes up the business world. Workers in government regulatory agencies have noted that there is no one business attitude toward "competition," especially in regard to whether a particular competitive practice, such as price discrimination, is "unfair" or calls for government regulation.

Depending on whether the businessman represents a large or small firm, and whether his industry is expanding or declining, his opinion of the extent of competition in a given market situation might differ. There might also be a difference in his evaluation of whether specified practices would help or hurt competition. As stated by a member of the Federal Trade Commission, Lowell Mason, in his dissent to the Commission's Standard Oil decision:

"When you meet your competitor's lower price so as to keep a customer he sought to take away from you, he feels he has been injured. Of course he has, but that

does not mean that competition has been injured. On the contrary, it may have been improved.

"In theory, it would be nice if one could do business without having people come along and meet his price. But in a free economy people are always trying to do that very thing: inveigling customers away by better services or cheaper prices. That's the consumers' protection. The well-established companies refer to these people as 'chiselers.' Those who are not well established, and who are trying to secure a foothold in the market place, refer to the well-established companies who meet their lower prices as 'monopolists' or 'price discriminators.' It all depends on which foot the shoe is on."

To what extent can generalizations be made regarding the meanings to men of affairs of "competition" and "injury to competition"? Further, does this suggest a way of determining whether or not injury to competition has occurred which avoids confusion with the question of injury to individual competitors?

We shall attempt to answer these questions on the basis of a consideration of public statements made by businessmen, and of the testimony of businessmen in cases where the Robinson-Patman Act has been enforced.

Meaning of "Competition"

Competition in its ordinary business sense means that rival companies exist and that to a greater or lesser extent these companies attempt to divert trade from each other. The market in which this competition takes place is not the impersonal,

atomistic market of perfect competition, and often consists of only a few firms or includes very large firms.

When there are few firms, the actions of at least some of them will be watched by the others. Such actions, when observed, will be sufficient to result in offsetting actions by the others. Since price cuts are readily countered, open price cutting is not an attractive means of rivalry for such firms unless one of them believes that its share of the increase in the total market will make the price cut profitable.

Otherwise each firm will seek to avoid open price cutting, and will try rather to match the prices of its rivals. Thus, the desire to divert trade from competitors is often manifested only in attempts to offer a better product, a distinctive product, or better delivery and service of the firm's product.

If, however, as is often the case, agreement cannot be reached among all competitors as to the "unwisdom" of price competition, it will probably be an important part of the competitive picture. A firm must then be willing to initiate or to meet lower prices in the market, particularly if the buyers have a good knowledge of prices.

It must always be remembered, of course, that to many businessmen, competition can exist in "vital" form without price competition. Other types of competition may be exceedingly troublesome in themselves. "Competition" as a term may mean many things other than those which are normally included in the concepts of price and non-price competition.

Sutton, a sociologist, and his colleagues in the field of economics have written that businessmen broaden the

meaning of competition to mean "any pressure from without the firm which impinges on management and influences management decisions, whether it arises from business firms in other markets, suppliers, customers, or the general public."⁴

Workable Competition

There is a great similarity in the thinking of some businessmen to the economic thinking in the concept of "workable" competition. As expressed by Corwin D. Edwards, "This competition consists in access by buyers and sellers to a substantial number of alternatives and in their ability to reject those which are relatively unsatisfactory."⁵

There is evidence that the concept of workable competition has been picked up and incorporated into business thinking regarding desirable types of competition. The National Association of Manufacturers Research Department has written that, from the viewpoint of the individual buyer, the intensity of competition "depends on the number of alternative choices open to him." This point serves as a basis for the further statement that a few producers, each selling a national market, are more competitive than a large number of producers, each operating in a single locality where few or no competitors are found.

The viewing of competition in terms of availability of alternatives to buyers is also reflected in the following statement of the Procter and Gamble Company:

"It seems unwise to produce Product A and ignore the preference of the 45% favoring Product B if the market is sufficiently large to carry both. Production of the

second product adds to the variety of products available to the consumer. This breadth of choice is the basis of modern supermarket merchandising. . . . [This] thinking merely carries the principle of competition, which is basic to the functioning of the American economy, one additional step.²⁹

Joseph Seitz, the president of Colonial Stores, reflected this view of competition in a year-end statement: "Competition during 1957 might become intense to the general benefit of the consumer. . . . The most significant trend in food retailing today, it seems to me, is that we are giving the consumer constantly increasing freedom of choice."³⁰

Symbol of Fair Play

But competition plays much more than a logical role in the thinking of businessmen. As a symbol of fair play it has a widespread emotional appeal both inside and outside the business community. The explanation given by Sutton and his associates for this appeal is that competition symbolizes our society's basic patterns of universalism and achievement:

"In all kinds of contests—athletic, scholastic, political, occupational, as well as business—we have a strong moral commitment to open the race equally to all, to impose the same rules on all contestants, to expect each to do his best within the rules to win, to award prizes to the winners, to applaud the efforts of the losers and expect them to be 'good sports.' Nothing is more important than 'fair play'—an equal chance for all contestants and adherence by all to a set of impartial rules."³¹

The symbolic idea of competition described above has been reflected in the statements of businessmen. Edward H. Thurston, late vice-president and director of Liggett and Myers Tobacco Co., once said, "The competition was very fierce, or a better word, I think, is 'rivalry.' 'Rivalry' describes it much better than 'competition.' It was just the same kind of rivalry as in a football team or a baseball team."³²

Even under the basing-point system, an appeal to "fair play" was made by Kosmos Cement Company in a letter to the Louisville Cement Company protesting price irregularities by the latter company. The letter stated in part, "You also recognize an obligation of what I might call sportsmanship to compete with the companies on their own level."³³

The necessity for "fair play," "an equal chance for all," and "a set of impartial rules" cited by Sutton, et al., is also reflected in the following excerpt from a letter to a U. S. Congressman by George J. Burger, vice president of the National Federation of Independent Business:

"In the booklet of the United States Chamber it states as a recommendation, item No. 3: 'Buying Goods well bought are half sold.' Well, there can't be any argument on that. That is the reason why you and 392 other Members of the House recently voted for the needed amendment to the Robinson-Patman Act . . . to protect present small business and those going into business, to see that they get a fair and equal price from their supplier. . . . Another comment in the booklet is: 'The successful merchant is the man who gives good values for the dollar and plays

fair with everybody.' We will go along with that 100 percent provided the supplier plays fair with all his customers, and not just a favored few."¹¹

In a similar vein, a pamphlet of the United States Wholesale Grocers Association states:

"The first principle of competition, whether it be in business or sports, is that all contestants be treated fairly and none be given an unnatural advantage not given to the others. This is an elemental rule of fairness without which there can be no contest, no real competition. . . . The Robinson-Patman Act is a basic necessity for preserving competitive opportunity.

"It serves as an umpire whose job it is to make sure the game of competition is played fairly. Allowing a favored few to defeat their rivals by securing discriminatory advantages through unfair use of superior buying power or through economic pressure violates a basic principle of competition."

Meaning of "Injury"

The historical purpose of the addition in the Robinson-Patman Act of the standard of "injury to competition with" a grantor or beneficiary of price discrimination was to prevent "unjust" injury to individual competitors or groups of competitors. This narrow standard of injury to "competition with" is as much a part of the law as the broad economic standard of injury to market competition.¹²

Many businessmen would agree with the published statement of the National Association of Manufacturers which argues that injury to competition occurs only when monopoly or conspiracy exists. After defining

monopoly as the opposite of competition, the Association goes on to say that monopoly exists when there is only one seller or, if more than one seller, they act as a unit in determination of price and conditions of sale. Subsequently the statement seems to limit harmful conspiracy to those cases where the supply is controlled so as to "fix a price that will yield the members the largest possible profit."¹³ This almost suggests that conspiracy to charge a "fair price," assuming this price is less than the profit maximizing price, would be harmless to competition.

N.A.M. List

The N.A.M. goes on to list the following specific practices as injurious to competition: trusts, holding companies, merger (if "real intent" is determinable), local price cutting to destroy competition, loss leaders, and "special arrangements . . . made with jobbers and involving special rebates or discounts and sometimes the boycotting of certain independents."

The list is apparently based on practices of firms which have been found guilty of violation of our anti-trust laws. Sutton and his colleagues have commented that, in published statements, businessmen have reduced the question of adherence to competitive norms to one of conformity with the anti-trust laws. Thus, failure to be prosecuted can be interpreted as a certificate of conformity to the competitive code. It follows that conspiracies are isolated instances in a class with embezzlement and fraud.¹⁴

Let us turn from statements intended for publication to a more grass roots appraisal of the meaning of injury to competition. In the F.T.C.'s *E. B. Muller* decision¹⁵ we find re-

ported as evidence some interesting correspondence among businessmen who had little doubt that injury to competition was taking place in their market.

Case History of Competitive Injury

Only three firms were engaged in the processing and sale of chicory, a product which can be mixed with coffee to impart certain flavors. The principal market for chicory was New Orleans, but it was sold all over the United States. Forty percent of Muller's sales were in the New Orleans territory, and 75 percent of the sales of Heinr. Franck Sons, Inc., were in that territory, while all of the sales of R. E. Schanzer, Inc., were in the New Orleans territory. There was a common control of the Muller and Franck companies, and they were in agreement not to compete for each other's business.

Schanzer was the principal importer of processed chicory. After the tariff on processed chicory was increased at the petition of Muller and Franck, Schanzer, in 1930, installed a plant in New Orleans for processing imported chicory root. In 1933, Schanzer installed a plant for processing domestic chicory root in Michigan, the only state in which it was grown. The reaction of Muller and Franck was to embark on a program of local price cutting in the New Orleans territory. The purpose was to eliminate Schanzer, their only competitor.

The value of competition in the market was evident to the purchasing officer of a large user of chicory, who in 1937, wrote in an inter-company communication:

"There is no getting around it but what if Schanzer had stayed out of

the picture we would be paying much higher prices for chicory from either Heinr. Franck or Muller so we really owe something to them. Muller and Franck have always had an opportunity to quote on our business and they always quoted the same price. Now, since Schanzer has gotten the business they are making a strenuous effort to get it back and just the minute that they have eliminated Schanzer I feel quite sure that their prices would be much higher."¹⁶

Intimidation

The perpetrators of the "injury" in this market also seemed to have a very clear picture of the meaning of the term "injury to competition." The sales manager of the Muller company wrote the Port Huron office as follows: "We would suggest that they be given a price of 6 cents Jacksonville, . . . unless different information should come to hand of Schanzer having actually closed up entirely, in which case of course, a better price could be obtained."¹⁷ The sales manager also used the possibility of creating a monopoly as a threat to purchasers. Again utilizing the idea of available alternatives to the buyer, he wrote a sales representative:

"However, we feel sure that if you will diplomatically advise your trade that Schanzer surely will not last much longer, which is certainly proven by the repeated offers he has made to us to buy him out, they will see the handwriting on the wall, and realize that if Schanzer drops out, which he undoubtedly will, they will have to come back to us, and it should appear reasonable to them to consider that we would not feel so kindly towards those who

have gotten away from us for a slight consideration in price, than to those who stuck to us and they would be the ones in future who will receive the greatest consideration. . . . Of course it is needless to tell you that this will have to be handled very carefully, not in the nature of a threat but just as a friendly suggestion on your part, and we believe it can be handled very much better by you than by the writer, as such *intimidation* coming from him would not take as well."¹⁸ (Italics are the author's.)

Observing that the predatory tactics on Schanzer might result in entry of new firms, the need was seen for warding off such potential competition under threat of "injury." Again in terms of alternatives in the market, the president of Muller wrote:

"There is the danger in letting one customer get too big as we have done by rebates to Reily. Reily has been able to undersell his competitors through our help and when he gets big enough he will unquestionably attempt to go into the business himself. The only thing that will prevent him will be the fear that if he does do this there will be a fight and every 5 bag buyer in New Orleans will get his chicory just as cheap as Mr. Reily can produce it for himself. Reily would not be able to sell much outside of his own trade and if his chicory costs him as much as his small competitors, all of Reily's advantage is gone."¹⁹

While attempting to reduce the number of alternatives to the buying side, the president of Muller recognized the desirability of many alternatives to his, the selling side of the

market, writing in the letter previously quoted, "we are damaging our other . . . trade by giving Reily such a large rebate. It is dangerous for us to increase Reily's trade at the expense of his competitors."

In this case, there is an identity of injury to competition with injury to a competitor, since Muller and Franck were in agreement not to compete with each other, and Schanzer was their only competition in the market for chicory. Since there was no possibility of confusion of the two concepts of injury in this case, it provides an excellent source of non-public beliefs of businessmen as to the nature of competition and injury to competition.

A rather remarkable aspect is the recurrent reference to availability of alternatives as a measure of competition. Furthermore, this availability of alternatives is viewed as a protection to firms on the other side of the market, whether it be the buying or the selling side. This grass roots concept of competition, which was brought to light through a search of company files, was expressed three years before the enunciation of the concept by economists.

Confusion of Terms

Regardless of his thinking about "competition" in general, there is evidence that, in specific cases, many a businessman is prone to make his determination of "injury to competition" turn on whether or not there is "injury to a competitor"—specifically himself. Primarily occupied with his own company, and with little time for analysis of the industry, much less the overall economy, he often has no reason to think that competition has been injured unless *he* has been injured.

For example, there is widespread feeling that if favored firms do not use price advantages to reduce their own prices and thereby divert trade, they have done no "injury" to their competitors, therefore there is no injury to competition.

Morton Salt Case

Thus, in the *Morton Salt* case,²⁰ witnesses were asked two questions: "If you were selling Morton's Blue Package salt at \$1.65 per case while at the same time a competitor seller was selling it for \$1.63 per case, would your business be affected?" and "If you were paying \$1.50 per case for Morton's Blue Package salt while a competitor was paying \$1.40, would your business be affected?" Twenty-nine of the fifty-one witnesses "observed that while the competitor enjoying the discount might have an opportunity to make more profit, there would be *no effect on competition*, if . . . the discount was not used to reduce the sale price of the product." (Italics are the author's.)

Of course this interpretation is to ignore the function of profits in the allocation of resources, and also, more at home to the businessmen, to ignore the fact that profits might be used for non-price competition or for expansion of the competitor receiving the greater profits.

The feeling that a discriminatory price advantage causes no injury to competitors of the favored firm unless that firm chooses to reflect the advantage by price cutting is also illustrated in a series of cases involving automobile parts.²¹

In these cases, jobbers who had been disfavored by price discriminations denied that they had been injured as a result. They admitted how-

ever that their basis for believing that they were not injured was "the fact that their competitors all followed the suggested resale price" and "that there was no price competition in their particular trade areas." (It is also possible that the "disfavored" witnesses enjoyed favored positions in the purchase of other items, and did not wish to do anything that might lead to an upsetting of these relationships.)

Minneapolis-Honeywell Case

A businessman whose firm is doing well may think of price differentials as just part of the normal competitive picture along with numerous other advantages and disadvantages, one competitor having one advantage and another competitor having another advantage. Thus, in the *Minneapolis-Honeywell* case,²² some burner manufacturers who paid higher prices testified that "they did not lose business as a result of paying such higher prices, and that they considered other factors of far greater importance in determining the price of the completed burner. They referred to such matters as manufacturing methods, overhead, distribution costs, service, advertising, as having an important bearing on competitive prices in addition to the costs of the component parts."²³ It appears that these particular businessmen felt that, on balance, they were not injured by competition, such as it was, and therefore there was no injury to competition.

Others of the burner manufacturers testified that they had lost business to certain competitors because of the price differential, therefore implying injury to competition. To firms in the burner industry, the test of injury to competition was apparently whether or not the firm was losing business.

This test not only ignores effects on the vitality of market competition, but even ignores types of injury which might occur to the individual firm, even though it is gaining sales.

A firm which is gaining sales would be declining in its relative importance in the market if the market were expanding at a faster rate than its sales. And even if a firm is gaining in market share, its gains might well have been greater, if its competitors did not enjoy the benefit of discriminatory treatment from suppliers.

Turning to effects on market competition in general, if some of the competitors work under a persistent handicap unrelated to efficiency, this destroys the validity of the competitive process as a means of reducing the importance of inefficient and unwanted firms and increasing the importance of those firms which make better and more efficient use of resources.

Workable Competition

There is clearly a need for a logical distinction between "injury to competition" and "injury to a competitor." In cases such as the Muller case, injury to competitors would occur along with injury to market competition, but in other cases, such as those involving collusion, there might be no injury to competitors although market competition was virtually eliminated. In still other instances competitors might be injured while market competition was unaffected or even improved. The latter case might be the result, for example, of promotional pricing on the part of a firm with a superior product. Let us see if the concept of workable competition can suggest an approach to determination of "injury to competition" which avoids its confusion with "injury to a competitor."

Generally speaking, in terms of workable competition, if the real alternatives in the market are increased, competition is improved; if the real alternatives in the market are decreased, competition is injured. But due allowance must be given for the competitive process of selection whereby inefficient and undesired alternatives are eliminated. Thus, the presence of effects indicating possible injury to competition might be offset by other effects indicating that there was actually an improvement in competition.

For instance, if there were numerous suppliers all of whom were lethargic, the entry into the market of an experimental and alert competitor might, by subsequent elimination of inefficient firms, cause a reduction in the number of sources of supply and also cause a greater responsiveness of the remaining traders to profit and loss incentives.

There would be an elimination of those firms who were unresponsive to the market, but the remaining firms would actually afford the public a greater variety of real alternatives than existed with the greater number of suppliers. Here a reduction in the number of suppliers is actually an indication of the vitality of competition rather than of an injury to competition. While the elimination of lethargic competitors clearly indicates injury to those eliminated, it would not indicate injury to competition itself.

It should also be noted that it is possible for the current or short-term effects on competition to differ from the predicted or likely subsequent effects on competition. Thus, the elimination of competitors may reflect active competition for a period of time, as indicated above, but, if this results in the

elimination of all competitors but one, a later consequence is that of a severe injury to competition in that competition itself would be eliminated. In cases where the immediate effects of a practice differ from the subsequent effects, the controlling effects, for overall evaluation, would generally be the subsequent effects.

Short vs. Long Term Effects

This is because the short-term effects would be clearly temporary, and conditions would be tending toward the subsequent effects. It must be considered, however, that we cannot be as certain of the nature of the ultimate effects, since they are further away in time. The more uncertain the ultimate effects, the more weight must be given to the short-term effects.

Change is cumulative, and effects now deemed subsequent can themselves be superseded by still later effects. If, for instance, it is anticipated that competition will eliminate all but one competitor in a market, a subsequent increase in price might attract new competitors into the market. Thus entry, or simply the likelihood of entry, of new competitors tends to keep the prices of existing firms near the competitive level, and also tends to make the latter firms efficient and progressive, since otherwise there would be an entry of additional competitors as a result of the profit opportunity.

Ease of entry into the market also makes collusive price agreement among existing firms less attractive, since an increase in price may cause newcomers to enter the market, thus reducing the market shares of the initial participants in the agreement. The agreement itself could be wrecked in the process.²⁴

Weakening of Competition

Injury to competition may take the form of a reduction or weakening of competition, as well as that of an elimination of competition. Therefore, the existence of competition in a market does not mean that competition could not have been injured in that market, or even be in process of being eliminated from the market.

The determination of "injury to competition" implies a relative evaluation of the competitive situation with and without a given act or practice such as price discrimination. Rather than the more difficult, and more debatable, problem of determining to what extent a given type of competition exists, the problem here is one of whether or not the forces of competition are improved or injured.

Yardstick for Injury

On the basis of the concept of workable competition as expressed by Corwin D. Edwards,²⁵ determination of whether or not a practice results in injury to competition would involve answering the following questions:

1. Does, or will, the practice result in the elimination of a substantial alternative or group of alternatives in a market for substantially the same product or service?
2. Does, or will, the practice result in an important rival or group of rivals substantially limiting their competitive activities in order to appease, come to terms with, or avoid or lessen price warfare with a firm utilizing the practice? Does, or will, it result in a trader becoming so large that his rivals lack capacity to take over a substantial part of his trade?

3. As a result of the practice, is there, or will there be, a substantial trader or group of traders who are less responsive to profit and loss incentives?
4. Does, or will, the practice facilitate an arrangement which substantially limits the extent of price competition among rivals?
5. As a result of the practice, is it, or will it be, substantially more difficult for new traders to enter the market?
6. Does the practice substantially reduce the access by important traders or groups of traders on one side of the market to important traders or groups of traders on the other side of the market, or will it have this effect?
7. Does, or will, the practice substantially implement a preferential status for an important trader or group of traders on the basis of law, politics, or commercial alliances?

Basis for Decision

While one or more of these effects may be readily apparent in some sets of facts, in other cases there may be alternative explanations of the evidence. In such cases, one might proceed in the determination of the above listed questions by asking the question, "Based on the facts, is there reason for the practice having this effect on the trader?"

If the answer is affirmative, one could then ask, "Are there any additional facts or relationships which would accompany this effect, but which would not otherwise exist?" The presence of such additional facts or relationships would constitute a relatively solid basis for decision.

There may in any case be disagree-

ment as to how important the affected firms were, and whether the reduction in alternatives was substantial or not. This determination would not necessarily be difficult, however, for many, if not most, cases would be such that the alternatives involved would either be rather clearly substantial, or else insignificant in the market.

It must also be remembered that in imperfect markets some degrees of price discrimination, lack of knowledge, barriers to entry and exit, and inefficiency are to be expected, and caution must be exercised before concluding that a given effect on the market structure is due to any one of them.

Reduction in Alternatives

If a reduction in alternatives is due to inefficiency, we may not improve the situation by elimination of price discrimination which also happens to exist in the setting. We must make a judgment of whether or not the price discrimination was one of the means responsible for reduction in alternatives.

Thus, not only the effects on the market structure, but also the means by which the effects took place must be considered as part of the concept of injury to competition. If other possible causes, such as inefficiency, are considered unimportant, and the presence of a practice capable of injuring competition can be shown, this—if accompanied by one of the effects listed in this section—would constitute as much basis as could be logically found²⁹ for a determination of injury to competition.

Although for many businessmen the symbolic aspect of competition is one of its most important elements, it is unlikely that anything near a general agreement could be reached as to

whether or not many practices (e.g., specific cases of secret arrangements or of favoritism) were "fair" or "sportsmanlike."

Conclusions

The diversities among firms, of size, relative position, and prospects, as indicated in our introduction, mean that an agency attempting to act as an umpire of fair play would likely end up either as a proponent of one of several views as to what is "fair," or else wash its hands in the manner of Pilate.

On the other hand, there may be certain practices on which fairly general agreement could be reached. In such cases an attempt could be made to specify the practices which were to be prohibited. The main problem would be to confine the list to practices which have a negative or a neutral effect on the forces of competition.

There would be temptations on the part of some businessmen to seek the prohibition of practices hurtful to competitors, but helpful to competition itself. Thus, price-cutting would be considered by many businessmen

as chiseling or failing to play the game, and therefore be considered as an injury to competition.

Perhaps the best hope for greater consensus by businessmen as to the nature of injury to competition lies in the concept of workable competition. This is because of the widespread incorporation into present business thinking of the idea of "available alternatives" which is a central part of the concept.

Furthermore, many of the tests of workable competition, such as "no trader so powerful as to be able to coerce his rivals," "no deliberately introduced obstacles to access by traders to those on the other side of the market," and "no substantial preferential status," would also be accepted on the basis of the businessman's symbolic idea of competition—sportsmanship and fair play. General acceptance by businessmen of such a standard would also have the advantage of isolating the broader concept of "injury to competition," thus reducing the likelihood of its confusion with injury to an individual competitor.

REFERENCES

1. To be illegal under the Act, a price discrimination must be such that its effect may be "... substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . ."
2. *Report of The Attorney General's National Committee To Study the Antitrust Laws* (Washington, 1955), pp. 164-5. Also see Corwin D. Edwards, *The Price Discrimination Law* (Brookings Institution, 1959), pp. 518-45.
3. *Standard Oil Co. of Indiana*, 43 F.T.C. 56, 65-6 (1946).
4. Francis X. Sutton et al., *The American Business Creed* (Cambridge, Harvard University Press, 1956), pp. 176-7.
5. *Maintaining Competition* (New York, McGraw-Hill Book Company, Inc., 1949), p. 9.
6. Procter & Gamble Co., *Intra-Company Product Competition* (1956).

7. News release for 1956 year-end business sections.
8. *The American Business Creed, op. cit.*, p. 366.
9. Transcript of Record, Vol. VII, p. 4512, *American Tobacco Co., et al., v. U.S.*, 328 U.S. 781 (1946).
10. *The Cement Institute*, 37 F.T.C. 87, 146 (1943).
11. Letter of July 18, 1956, to Congressman Frank Thompson, Jr.
12. While our discussion is largely concerned with the broad standard of injury, it must be remembered that the Commission and courts have an additional standard to enforce as well. Under this additional standard of "fairness," the law can be violated by price discrimination which results in injury to individual competitors, and regardless of the effects on market competition. Even though an enforcing agency finds a violation of the Act in cases where a finding of injury in the broad sense would not be justified, this alone does not mean that the agency has confused "injury to competition" with "injury to competitors." Since price discrimination can be illegal under either standard, the enforcing agency could hardly dismiss a case where either of them applied. If the agency wished to bring enforcement into accord with an economic approach, however, it could seek to limit its selection of cases for complaint to those in which the broader, economic standard seemed to apply.
13. *The American Individual Enterprise System* (New York, McGraw-Hill Book Company Inc., 1946), Vol. II, pp. 592-4.
14. *The American Business Creed, op. cit.*, pp. 368, 166.
15. 33 F.T.C. 24 (1941).
16. *Ibid.*, pp. 51-52.
17. *Ibid.*, p. 52.
18. See note 17.
19. See note 17, p. 53.
20. 39 F.T.C. 35 (1944).
21. *Moog Industries, Inc.*, 51 F.T.C. 931 (1955); *Whitaker Cable Corp.*, 51 F.T.C. 958 (1955); *P. and D. Manufacturing Co.*, 52 F.T.C. 1155 (1956).
22. 44 F.T.C. 351 (1948).
23. *Minneapolis-Honeywell Regulator Co. v. F.T.C.*, 191 F.2d 786, 791 (7th Cir. 1951).
24. Ease of entry would also serve as a limit to effective predation, since new firms might rise up to replace those eliminated at a cost to the predator. I feel, however, that successful use of predatory price discrimination would itself result in a barrier to entry of new firms. See also Robert C. Brooks, Jr., "Price Cutting and Monopoly Power," *Journal of Marketing* (forthcoming), Vol. 25, 1961.
25. *Maintaining Competition, op. cit.*, pp. 9-10.
26. Logically, causality cannot be proved, but can be inferred. The conditions given in the above paragraph would make the inference of "injury" reasonable, and a more solid basis could never be found in such relationships.



LETTERS TO THE EDITORS

Life Time Products Corporation
Los Angeles 25, California

Managing Editor
California Management Review
Los Angeles 24, California

Dear Sir:

An article by Mr. J. Grant MacDonnell titled, "A Struggle to Reward Good Executives," published last year in your spring edition, presented such an excellent and provocative review of executive compensation programs that it launched our company into a detailed study of one of the more novel approaches presented therein. I am happy to report that at a recent meeting, our directors approved a new deferred compensation program based largely upon Mr. MacDonnell's suggestions.

We have high hopes for this approach to the compensation of our key personnel and wish to congratulate the *California Management Review* on its eminently practical approach to the presentation of the problems of business executives, as illustrated in both this article and many others which we have read.

Sincerely,
C. Wesley Morse
Vice President & General Manager

Managing Editor
California Management Review
Los Angeles 24, California

Swissair
% Convair
San Diego 12, California

Gentlemen:

May I comment on the article entitled, "Quantitative Methods of R & D Management," by Raoul J. Freeman, which appeared in Volume II, Number 4 of the *California Management Review*.

I found the article to be extremely interesting, however I wish to point out an error that apparently crept into the formula shown on page 43 under Appendix II. t_e should read " $t_e = \frac{1}{3} []$," instead of $\frac{1}{2}$. The $\frac{1}{2}$ of course gives completely erroneous results for expected time.

I wish to say that I always enjoy reading the *California Management Review*.

Very truly yours,
H. P. Schulthess

C E I R, Inc.
Arlington 2, Virginia

Dear Professor Buffa:

Mr. Schulthess is quite correct in his comment regarding the $\frac{1}{2}$ which should be $\frac{1}{3}$. We stand corrected. It was a proofreading error.

Sincerely,
Raoul J. Freeman
Project Director

Blyth & Co. Inc.
Los Angeles 14, California

Dear Sir:

I have recently read the article "Stock Dividends are Lemons, not Melons" appearing in the Winter, 1961 issue. I regret to say that I disagree with the conclusions reached by the author, Stephen H. Sosnick. It seems to me that he has missed the basic advantages of stock dividends and instead has concerned himself with the minor disadvantages inevitably present in stock dividends. Whether a stock dividend is a lemon or a melon, I believe, can best be proven by a study of the market action of companies utilizing stock dividends. I agree that some companies may use stock dividends to fool the public, but other companies utilize stock dividends as a tangible evidence of growth in earnings.

I refer in particular to the stock dividend policy of Purex Corporation, Ltd. I am enclosing a copy of an analysis of the growth of this firm, published in October 1959 by Blyth & Co. Inc. which sets forth on page 12 that:

"It is the policy of the Board of Directors to have the shareholder participate in any growth of earnings consistent with the necessary cash to finance the expansion program. Accordingly, in 1956 the Board announced a policy of considering each year the payment of a stock dividend to supplement the cash dividend.

"Each August the Board reviews the results of the year just completed and declares a stock dividend roughly equal in market value to the Company's retained earnings for that year. Pursuant to this policy, the Company has paid one 3 percent and three 4 percent stock dividends in the past four years, and in addition the cash dividend per share was increased in each of those years. Also, a 100 percent stock dividend, in effect a 2-for-1 stock split was declared in March 1959. At its dividend meeting in August 1959, the company declared a 4 percent stock dividend and increased the annual rate of its cash dividend from \$0.60 to \$0.70 per share. During the past four years the Company has paid out in cash dividends an average of 41 per cent of its earnings."

This policy is still in effect at the Purex Corporation.

I have hesitated to write this letter because in general I have enjoyed reading the various articles published in the *California Management Review*, but I feel that you should know that there are other factors and opinions which should be considered in determining whether a stock dividend is a lemon or a melon.

Sincerely yours,
Richard M. Link
Vice President

University of California, Davis
Department of Agricultural Economics

Dear Professor Buffa:

I am happy to have this opportunity to comment on Mr. Link's reaction to my article on stock dividends. Although his letter is in summary form, perhaps I can deal with the issues he has in mind.

One of his points is that I concerned myself with minor disadvantages of stock dividends. I agree that the reduction of surplus will appear minor in prosperous times or to prosperous companies. I also agree that adjustment of previously reported data will appear minor, since the costs are not large and are borne primarily by outsiders. I even agree that the costs to the corporation and to the stockholders will appear minor, since they are small when expressed per old share—although hardly negligible in absolute amount, as I tried to demonstrate. But will Mr. Link, who concedes that these disadvantages are "inevitably present," not also agree with my statement on page 65 of the article that they "suffice to put a burden of proof on those who claim that a stock dividend would be beneficial"?

Apparently he has two kinds of benefits in mind and for neither one is there substantiation. One is "tangible evidence of growth in earnings." There has been an interesting debate as to whether cash dividends may serve as a substitute for earnings reports in indicating companies' long-run earning power (see the literature in the article cited in reference 17). But stock dividends are not substitutes for earnings reports. They are evidence of nothing except that the amount charged to surplus will not be available for cash dividends (see pp. 62-63 of my article). This will be clear unless stock dividends are being equated with cash dividends.

If they are, either Mr. Link can mention some error in the analysis on pages 61-62 and reference note 19, or else he agrees that people who require or accept stock dividends as evidences of growth are being fooled.

The other kind of benefit is a gain in market value. Mr. Link believes, according to his letter, that the worth of stock dividends "can best be proven by a study of the market action of companies utilizing" them. I presume he means a controlled test, since the question must be whether the stock dividend was associated with more favorable results than otherwise would have occurred. Whether Purex common moved (and stayed?) higher when (every?) stock dividend was declared (or decided or issued?) provides no test unless it is known what would have happened otherwise.

One type of controlled test is comparison with companies that did not issue stock dividends. Many such studies have been undertaken (see reference note 23). If the results were favorable to stock dividends, one might still wonder whether the control was adequate, since there is reason to believe that stock dividends have been used disproportionately by companies that are growing especially fast. But the upshot of these studies is, as I state on page 80 of the article, that "the evidence is, indeed, contradictory."

Even if the evidence favored stock dividends, the question would remain whether the gain was sufficient to outweigh the costs. Since the evidence of any gain is inconclusive, we have, of course, no measure of the amount of the gain to set against my cost estimates. (But I hope I have succeeded in getting across the point that both the gain and the costs can be influenced by wise selection of the percentage; see especially page 69 of my article.)

We would have the question whether a net gain, even if expected, was worth seeking. If the net gain will be the result of the investors' delayed awareness of dilution, there would be offsets in the prospect of decay and in the fact that the gain would accrue primarily to the original stockholders who promptly sold out (see page 67).

We would also face the question whether there are better means of obtaining the supposed net gain. For corporations with "true" no-par shares, a stock split of equal magnitude will be at least as good and often better (see page 69). For other corporations, it depends on whether amending and stamping outweigh taxes, surplus reduction and dilution problems (see page 70).

These considerations seem to leave Mr. Link with two alternatives. First, he can explain where I have misassessed the evidence in favor of stock dividends. Second, he can explain why the burden of proof does not rest on the proponents—just as it does, in this century, on Bridie Murphy.

Sincerely yours,
Stephen H. Sosnick
Assistant Professor

Managing Editor
California Management Review
Los Angeles 24, California

Graduate School of Business Administration
University of California, Los Angeles

Dear Professor Buffa:

In Professor Preston's article, "A Longer Look at the Sixties" (autumn issue of the *California Management Review*), he pointed out that real GNP grew by only 3.5% in the 1950's. He did not discuss the greatly increased emphasis that developed in the 1950's on improving the quality of goods and services being produced. This is an even more important type of economic advance than increasing the physical volume of goods and services being produced.

Since changes in real GNP do not reflect improvements in quality, I believe it is unwise to rely so heavily on this criterion. Furthermore, improvements in quality tend to add to costs and prices. Actual GNP is then deflated by the rise in prices to compute real GNP. Thus, many improvements in quality will serve to cause smaller rate of growth in real GNP as it is now computed. Paradoxically, if we could step up actual progress by raising the quality of goods and services much more rapidly, real GNP might well show a downward trend, because prices would be rising faster.

Expenditures on industrial R & D rose from \$10 billion in the 1940's to about \$62 billion in the 1950's. For the 1960's the figure is expected to top \$170 billion. Since these outlays have as a prime objective the development of new and improved goods and services, the prospects for quality advances in the 1960's are better than for any prior decade. In view of the growing importance of R & D, our studies of the past and prospective rates of economic advance appear to me to have quite limited value unless they take into account this factor.

Theodore A. Andersen
Associate Professor of Business Economics

Graduate School of Business Administration
University of California, Berkeley

Gentlemen:

The point raised by Dr. Andersen is, of course, extremely important, and like many important problems it is very difficult. The decomposition of price changes to show (1) that part of the change accounted for by a change in product quality, and (2) the remainder as a "pure" price change is really a part of the larger problem of discriminating between "old" and "new" products and of introducing the "new" products into the measurement of total output.

If, during a period of steady inflation, each "improved" product is treated as a "new" product and its full price added into the computation of total output, increases in output will clearly be overstated; conversely, if quality changes are entirely neglected, the change in output is understated. It is extremely difficult to discover what adjustments for specific price and quality changes are actually made in the computation of the national account; hence, it is doubly difficult to estimate the effect of all of these adjustments on the measurement of total output.

Dr. Andersen may be correct in believing that these adjustments are not made as well as they might be; I do not have sufficient information on which to make such a judgment and, as I said in my article, for my purposes "the standardized methods of adjustment must be accepted as at least approximately accurate" (p. 85). If real GNP is improperly computed, we should not place any significance at all on the results of the computations. If real GNP is properly computed it will not, of course, show a downward trend as a result of increasing product quality.

On Dr. Andersen's second point, I agree that the attention and money currently being directed toward activities described as "Research and Development" is indeed impressive. However, it is difficult to discriminate between significant increases in the importance of these activities and increases in their reporting due to changing institutional structure and terminology. Now that R & D is a recognized area of corporate planning, personnel and expenditures are explicitly allocated to it; however, the types of activity in which these people and monies are involved are at least as old as the Industrial Revolution.

Hence, although there is no doubt that R & D expenditures are growing, their growth relative to the total economy is more difficult to ascertain, and the impact of these expenditures on the total economy is even less clear. It need not necessarily be assumed, I think, that R & D expenditures will prove to be uniquely impervious to the Law of Diminishing Returns.

It was not my intention in the earlier article, nor is it in this note, to paint a gloomy picture of the future of the American economy; my intention was rather to inject an air of caution into current discussions, especially those which could be summarized as "bigger and bigger, better and better, faster and faster." I am glad to learn that someone of Dr. Andersen's experience and breadth of view sees considerable reason for optimism as to our long-run economic prospects.

Lee E. Preston
Assistant Professor of
Business Administration

LETTERS TO THE EDITORS / 107

Flying Tiger Line, Inc.
Lockheed Air Terminal
Burbank, California

Managing Editor
California Management Review

Dear Sir:

I would like to offer my congratulations on the Spring edition of the *California Management Review*. It was a most interesting and informative issue.

Most particularly the article on "Rhochrematics and Organizational Adjustments" should be of great interest to all executives involved in the flow of products to and from the industrial complex. We in the transportation field have long been aware that this area of business has not received the attention of top management, even though the possible savings are great.

I hope that articles exploring this concept further will be forthcoming in later issues.

Sincerely,
ROBERT W. PRESCOTT
President

Western Airlines
Airport Station
Los Angeles 45, California

Dr. Elwood S. Buffa
Managing Editor, California Management Review

Dear Mr. Buffa:

Congratulations on the last issue of the *California Management Review*. The new look is very impressive—clean, modern, easy-to-read.

Sincerely,
KENNETH O. SMITH
Director of Public Relations

General Telephone Company of California
Santa Monica, California
Office of the President

The Editors
California Management Review

Dear Sirs:

In a recent reader survey you invited subscribers to comment on your publication. I should like to take this occasion to do so and, in particular, to compliment you on the green (spring) issue. It has a distinct personality, and I hope you will keep the CMR looking this way, unique size and all. Please don't copy other business journals.

I think my impression is based on both the contents and appearance of the latest

issue. I particularly liked the paper on capital budgeting and the articles about corporations and their public responsibilities. The bright cover and the increased use of illustrations convey a crisp, modern impression. Your new type is very much clearer, what is it?

Sincerely yours,
ALLAN G. COOLEY
Assistant to the President

California Management Review
Editorial Offices

Gentlemen:

Thank you for your comments on the spring issue. We are glad you like its contents and are particularly interested in your questions about our new format. We too think our new type, paper, and illustrations are attractive and more importantly, an improvement in legibility over previous issues. That is the purpose of the new look—to make CMR easier to read and to save our readers time.

It is the result of much research and work on the part of our Assistant Editor, Charlotte Huber, Staff Artists Jerry Maffei and Samuel Bhang, and A. R. Tommasini, Superintendent of Printing at the University of California Press, where the *California Management Review* is printed. The project—Operation Restyle—began many months ago under Miss Huber's direction and resulted in the choice of bigger, clearer type and heavier, whiter book quality paper.

Typophiles like Mr. Smith and Mr. Cooley will recognize our body type as 10 point Caledonia with 2 point leading and our heads as Venus Medium Extended. Caledonia is a linotype face designed in 1940 by Dwiggins. Technically it is a "transitional" type which means that it goes well with both traditional and modern sans serif faces. In many respects it resembles the century-old Scotch Roman types from which it is derived, but it is a cleaner, more graceful face.

Many typographers consider Caledonia to be one of the most readable periodical type faces ever made. That is why we selected it for CMR. We're happy that you consider it in key with the material we publish and trust that in issues to come you will continue to find it not only good looking, but good reading.

Yours very truly,
ELWOOD S. BUFFA
Managing Editor

EDITORIAL POLICY

The *California Management Review* seeks to build a bridge between creative thought about management and executive action. In pursuit of this objective, the *Review* is intended to serve as an authoritative source of information and ideas contributing to the advancement of management. It is directed to active managers, scholars, teachers, and others concerned with management.

Specifically the *Review* will publish: 1/ Results of research in all areas of knowledge which have significance for the management of both public and private enterprises. 2/ Analyses of economic, political, and social issues and trends important to management. 3/ Descriptions and evaluations of new techniques in management. 4/ Discussions of theory, principles, and philosophy underlying business policies and operations. 5/ Reports of work in the other social sciences, in the humanities, and in the physical sciences having implications for management.

Manuscripts may be of whatever length necessary to present the material clearly and concisely. **They should be submitted in triplicate.**

The Editors extend a special invitation to readers of the *Review* to comment on the articles published. Comments and manuscripts should be addressed to:

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McKINSEY AWARDS

Prizes of \$1000 and \$500 will be awarded annually to the authors of the two best articles appearing in the *Review* that year. These awards have been made possible by the McKinsey Foundation for Management Research, Inc. Neither the Editors nor members of McKinsey and Company are eligible for them.

SUBSCRIPTIONS

The *California Management Review* is published quarterly by the Graduate Schools of Business Administration, University of California, Berkeley and Los Angeles. Subscription rates are \$6.50 for one year, \$15.00 for three years. Single copies are \$2.00. Prices for reprints are available upon request.

Make checks payable to The Regents of the University of California. Address all inquiries to:

California Management Review, University of California, Los Angeles 24, California.

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